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2019 Holiday Cheer: IRS Releases Final Qualified Opportunity Fund Regulations

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We thought we knew what we wanted for Christmas (at least one of us had made strong hints about Burning Man tickets). But the best gifts are surprises, and this year was no exception. Just days before the big day, the US Internal Revenue Service (the "IRS") released its gift of 544 pages of final regulations (the "Final Regulations") addressing the formation and operation of qualified opportunity funds ("QOFs).[2] The final regulations replace, but also synthesize and build on, two prior sets of proposed regulations.[3] This Legal Update provides a selective overview of the now-finalized rules.

The Final Regulations are generally applicable to 2020 and later tax years.[4] For 2018 and 2019, taxpayers may choose to rely on either the Final Regulations or the prior proposed regulations but cannot cherry-pick provisions from both sets.[5]

I. Brief Background

The legislative history accompanying the enactment of the QOF rules states that the provisions are intended to benefit low income communities by encouraging investments in such communities.[6] The IRS has promulgated a list of communities (by census tracks) that qualify as opportunity zones.[7] A QOF that invests in one or more opportunity zones provides the tax benefits described below for its investors.

Broadly speaking, the QOF rules operate as follows. An eligible taxpayer invests an amount equal to the capital gain that the taxpayer desires to defer into a QOF within 180 days from the date of the actual or deemed recognition of the capital gain. The QOF must be a partnership or corporation. This rule prevents the taxpayers who recognized the gains to be deferred from making qualified opportunity zone investments directly. The QOF then must make an investment in qualified opportunity zone property. Qualified opportunity zone property may be qualified opportunity zone stock, qualified opportunity zone partnership interests or qualified opportunity business property.

Mechanically, the statute operates on two separate tracks. One track governs the deferred gain and the second track governs the investment in the QOF. If the QOF investment is made prior to 2022 and the taxpayer holds the QOF investment for at least five years, he reduces the amount of the deferred gain by 10%. If the investment is made before 2020, and the taxpayer holds the QOF interest for at least seven years, another 5% of the originally deferred gain is reduced and the tax on such additional 5% is forgiven. In 2026 (or earlier if the investment is disposed of or there is another "inclusion event"), the lesser of the deferred gain (adjusted for the prior increases in basis) and

the excess of the fair market value of the QOF investment over the taxpayer's basis is then recognized and subject to tax at the then applicable tax rate.

Substantial tax benefits are available for the investment in the QOF itself as well. The taxpayer is initially deemed to have a zero tax basis in the QOF, despite having invested cash (or property). Then leveraging the rules for the deferred gain, the basis in the investment is increased by 10% after five years and by another 5% after seven years. The basis increase frees up losses deferred by the lack of basis in a QOF partnership interest (up to the amount of the increase).[8] If the investor holds its QOF investment for at least 10 years, the taxpayer may elect, on the date of disposition, to increase his basis to the fair market value of the investment. This rule provides a tax-free return on gains recognized with respect to the QOF investment held at least 10 years. In all cases, however, the income earned by the QOF during its life is taxed to the investor (or the QOF itself if it is a corporation) under the regular tax rules; that is, the QOF rules do not impact current income from the QOF investment.

A description of the QOF rules is complicated by the fact that the statute and Final Regulations contemplate two-tier structures in which the investors invest in a QOF and the QOF then invests in a lower-tier partnership (or corporation). The interest held by the QOF in the lower-tier partnership is one category of "qualified opportunity zone property" ("QOZP"). The lower-tier partnership will be QOZP only if its assets and operations meet specified requirements discussed below.

II. Date of a QOF Investment

In general, a holding period of property begins on the day following the day of acquisition.[9] The QOF provisions of the Code, however, provide that a taxpayer's holding period for a QOF investment begins on the date of the investment.[10] The Final Regulations acknowledge and sanction this disparity.

The date on which a QOF investment is considered to be made is crucial for many taxpayers seeking to take advantage of gain reduction rules. As described below, in many cases, gains from partnerships and certain other investments pass-through to taxpayers on December 31 of the year. A taxpayer may not make a contribution to a QOF prior to the date on which she recognizes a capital gain. Also as noted above, if a taxpayer desires to take advantage of the seven-year 5% gain reduction rule, she must invest in a QOF no later than December 31, 2019 (December 31, 2021 for the 10% gain reduction). The Final Regulations accommodate these overlapping rules by allowing taxpayers to make an investment in 2019 (and 2021) by making the contribution to the QOF on December 31, 2019 (2021). By making the investment on the last day of the year, the contribution will not be made prior to the date on which the gain is treated as recognized, and it is still made prior to the cut-off date for the seven-year 5% gain reduction rule. In 2021, the same situation will arise for the 10% gain reduction rule.

III. Gain Eligible to Be Invested in a QOF

The big change in the Final Regulations is that they now provide that eligible gains that may be deferred include gains from the sale or exchange of property described in Code § 1231(b) not required to be characterized as ordinary income by Code §§ 1245 or 1250, regardless of whether Code § 1231(a) would determine those gains to be capital or ordinary in character.[11] In contrast to the net approach of the proposed regulations, the Final Regulations allow gross Code § 1231 gains, without regard to any Code § 1231 losses, to be

rolled into QOFs. In addition, under the Final Regulations, the character of eligible Code § 1231 gains, other than as gains arising from the sale or exchange of Code § 1231 property, is not determined until the taxable year such gains are taken into account in computing gross income pursuant to Code § 1231(a)(4). In a very taxpayer-favorable change, the Final Regulations provide that the 180-day period for investing an amount with respect to an eligible Code § 1231 begins on the date of the sale or exchange that gives rise to such gain instead of the last day of the tax year.[12]

The Final Regulations retain the general rule set forth in the proposed regulations that limits eligible gains to gains treated as capital gains for federal income tax purposes. More specifically, eligible gains generally include gains from the disposition of capital assets as defined in Code § 1221(a), gains from the disposition of property described in Code § 1231(b), and income treated as capital gain under any provision of the Code, such as capital gain dividends distributed by real estate investment trusts and mutual funds.[13]

Under the Final Regulations, an eligible taxpayer's gain from a sale to or an exchange of property with an unrelated QOF ("acquiring QOF"), as part of a plan that includes the investment of the consideration received by the eligible taxpayer back into the acquiring QOF, is not eligible gain because the transaction could not be recharacterized as not being a sale or exchange for federal income tax purposes.[14] Similarly, an eligible taxpayer's gain from a sale to or an exchange of property with an acquiring qualified opportunity zone business ("QOZB") is not eligible gain to the eligible taxpayer if the sale occurs as part of a plan that includes (i) the investment of the consideration received by the eligible taxpayer back into the QOF that owns the acquiring QOZB, followed by (ii) the contribution by the QOF of that consideration to the QOZB. Furthermore, because the transaction is not treated as a purchase of tangible property by the QOZB from an unrelated party, the newly acquired property will not qualify as QOZB property under Code § 1400Z-2(d)(2)(D).[15]

The preamble to the Final Regulations clarifies that contribution of a promissory note to a QOF in exchange for an interest in the QOF is inconsistent with the policy underlying Code § 1400Z-2 to incentivize investments in QOZs. As such, the Final Regulations maintain that a taxpayer can make an investment in a QOF only by contributing cash or property.

IV. Calculation of the 180 Day Roll-Over Period

The Final Regulations made a few taxpayer friendly changes with respect to the 180 day roll-over period requirement. As discussed above, the Final Regulations have taken the "gross approach" for a section 1231 property. Under the revised approach, any gain on the sale or exchange of such property can be treated as eligible capital gain, regardless of whether there are losses from other section 1231 properties.[16] Under this gross approach, the 180-day period should begin on the date of the sale of such property, instead of the end of the taxable year. This gross approach can provide a significant planning opportunity for those taxpayers that have gains on some of its section 1231 properties but losses on others. They can shelter the gains by making QOF investments and then, subject to applicable limitations, use the losses against other income.

The Final Regulations generally provides that the 180 day period for capital gains dividends from a REIT or a RIC begins at the end of the shareholder's taxable year in which the capital gain would otherwise be recognized by the shareholder (instead of the end of the payer's taxable year).[17] A shareholder can elect to begin the 180-day period on the day each capital gain dividend is paid instead of waiting

until the end of such shareholder's taxable year.[18] For undistributed capital gain dividends, however, the 180-day period starts either on the last day of the shareholder's taxable year in which the dividend would otherwise be recognized or the last day of such entity's table year, at the shareholder's election.[19] In any event, the aggregate amount of a shareholder's eligible gain with respect to capital gain dividends in a taxable year cannot exceed such shareholder's share of the aggregate amount of capital gain dividends designated by such entity.[20] Any excess investment will be treated as a non-qualifying investment.

In the case of an installment sale, a taxpayer can elect to start the 180-day period either from (i) the date when a payment under the installment sale is received or (ii) the last day of the taxable year when the eligible gain under the installment would be recognized.[21] Thus, if an eligible taxpayer receives one or more payments on an installment sale, such taxpayer can elect to treat each payment as triggering a new 180-day period. Accordingly, at least a portion of an installment sales gain may be treated as eligible capital gain even if the underlying sale have occurred before December 22, 2017.[22]

The Final Regulations also relaxed the 180-day roll-over rules for pass-through entities other than grantor trusts. When a pass-through entity does not elect to defer gains under the QOF rules, partners or members in such entity may elect to defer their share of eligible capital gains. In such a case, the 180-day period generally begins on the last day of such pass-through entity's taxable year. However, the Final Regulations allows partners or members in a pass-through entity to elect to treat the 180-day period as commencing upon the due date of the entity's tax return to address the concern that such partners or members may not necessarily be able to collect all the necessary information to make the election. While a taxpayer is not allowed to take into account any extension of the filing due date,[23] this election can still provide a meaningful help to the taxpayers, particularly when their receipts of Schedule K-1s are delayed.

V. QOF Certification

The Treasury Department and the IRS received several comments regarding the certification process outlined in the proposed regulations. For example, several commenters recommended that the Final Regulations require a taxpayer to identify, at the time of QOF certification, the QOF's intended community development outcomes and objectives. The preamble to the Final Regulations explains that the suggested recommendations, while potentially helpful for directing such investment and limiting abuse, likely would present numerous obstacles for potential QOF investors and ultimately reduce, rather than increase, the total amount of investment in low-income communities. As a result, the Final Regulations do not adopt any recommendations from commenters. Please note that several pieces of legislation are pending that could impose very similar requirements to those rejected in the Final Regulations.

The Final Regulations include a provision to allow a QOF to self-decertify. The rule specifies that self-decertification becomes effective at the beginning of the month following the month specified by the taxpayer.[24] The month specified by the taxpayer must not be earlier than the month in which the taxpayer files its self-decertification.[25] For example, if a QOF determines to decertify in May, the earliest date that the QOF could be decertified would be June 1st, provided that all applicable procedures were followed. The Treasury Department and the IRS are developing additional instructions regarding QOF self-decertification including instructions regarding

the time, form, and manner of QOF self-decertification. The Final Regulations also include a rule providing that the decertification of a QOF, whether voluntary or involuntary, is an inclusion event for eligible taxpayers that hold a qualifying investment in that QOF.[26]

The Final Regulations confirm that preexisting entities are not barred from qualifying as QOFs or QOZBs.[27] Like newly formed corporations and partnerships, however, the Final Regulations require preexisting entities to satisfy all requirements applicable to QOFs under Code § 1400Z-2 and the regulations thereunder.[28] To value assets acquired prior to 2018 (which would not be QOZB property), the Final Regulations provide that preexisting entities must use either (i) the applicable financial statement valuation method set forth in final Treasury Regulation § 1.1400Z2(d)-1(b)(3), if the QOF has an applicable financial statement (an "AFS") or (ii) the alternative valuation method set forth in Treasury Regulation § 1.1400Z2(d)-1(d)(4).[29] Under the applicable financial statement valuation method, the value of each asset that is owned or leased by a QOF is the value of that asset as reported on the QOF's AFS for the relevant reporting period (rather than the adjusted tax basis of the asset).[30] Under the alternative valuation method for purchased assets, a QOF must use the QOF's unadjusted cost basis of the asset under Code § 1012, Code § 1013 (with regards to inventory) or its fair market value.[31]

VI. Acquisition of QOF Interests from Underwriters

The Code allows taxpayers to defer "the aggregate amount invested . . . in a [QOF]." Taxpayers were concerned that this language prevented purchasers of already-issued interests in QOFs from claiming QOF benefits. The Final Regulations, however, confirm that a purchaser of an outstanding QOF interest can claim QOF benefits. The Final Regulations specifically provide that a transferee can claim benefits even if the transferor of an eligible interest did not make an election to defer gain with respect to the amount contributed to the entity.[32]

VII. At-Risk Consequences of a QOF Investment

A taxpayer is generally considered having at-risk basis for an activity with respect to the amount of money and the adjusted basis of other property contributed by the taxpayer. Therefore, there has been a question whether an investor in a QOF will have at-risk basis with respect to its interest in the QOF to the extent that a taxpayer has no basis in the interest in the QOF because of the mandatory basis step-down upon contribution. The IRS stated in the preamble to the Final Regulations that the amount at risk is generally determined by reference to the amount contributed, not to the basis of interest received in exchange thereof. This suggests that an investor in a QOF may be considered as having at-risk basis in its interest in the QOF. However, the IRS has defined to provide any further clarification on this issue in the Final Regulations.

VIII. Special Considerations for Non-US Investors (FIRPTA)

The QOF statute does not require that the capital gains eligible for deferral under the QOF regime have otherwise been subject to US federal income tax. This led practitioners to believe that non-US persons who recognized capital gains not in connection with the conduct of a US trade or business could count such capital gains towards the amount that could be contributed to a QOF. The Final Regulations, however, take the position that only gains otherwise subject to US federal income tax can be used as the grounds for a contribution to a QOF that is eligible for QOF

benefits.[33] This position seems inconsistent with the purpose of encouraging investment in opportunity zones as non-US investors have been significant investors in US real property and other businesses. If, however, a partnership with non-US partners sells property, the partnership can nonetheless make a QOF investment, provided that the partnership does not run afoul of an anti-abuse rule.

When a non-US person disposes of an investment in US real property, the buyer of the property generally is required to withhold a portion of the sales proceeds in order to ensure that the non-US seller will pay the US federal income tax on any gain recognized in the sale.[34] No withholding is required when the non-US person disposes of the property in a non-recognition transaction.[35] The Final Regulations specifically refuse to treat a contribution by a non-US person as a non-recognition transaction.[36] Accordingly, a non-US person who desires to dispose of a US real property interest and invest the gain from such transaction in a QOF will be subject to withholding, even though the tax due as a result of such disposition will be deferred until 2026 (or an earlier inclusion event). This will require non-US investors desiring to invest real property gains in QOFs to file refund claims for withheld taxes. As a result, there is a strong disincentive for non-US investors to rollover gains in US real property into QOF investments.

IX. Inclusion Events

The Final Regulations designate the events that can trigger an early recognition of deferred gain (in whole or in part) as "inclusion events."[37] Inclusion events also affect the investor's holding period in his QOF investment. Thus, inclusion events have impacts for both QOF tracks. In a positive change from the proposed regulations, an inclusion event does not prevent the remaining deferred gain from being eligible for the five-year and seven-year gain exclusion and basis step-ups. Instead, under the Final Regulations, an inclusion event proportionately reduces the step-ups.[38] For example, if an inclusion event that occurs prior to five years results in recognition of 20% of the deferred gain, the five-year and seven-year gain exclusion and basis step-ups are reduced by 20%.

In general, inclusion events include transfers of QOF interests, distributions from a QOF and the claiming of a worthlessness deduction with respect to a QOF interest.[39] The Final Regulations contain a list of rules in specific 14 situations.[40] Under these special rules, a contribution of a QOF interest to a partnership is not an inclusion event, provided that the contribution does not cause the QOF to terminate.[41] The tax attributes of the QOF interest are considered to be personal to the contributor and any deferred gain and gain recognized with respect to the contributed QOF interest must be allocated to the contributor. These special rules also permit mergers of QOFs without triggering inclusion events, provided that the resulting partnership is a QOF.[42] A check-the-box election for a QOF partnership to be taxed as a corporation is an inclusion event.[43]

The most important special rule provides that a distribution by a partnership is an inclusion event only to the extent that the amount of cash (or the fair market value of property distributed) exceeds the partner's basis in the QOF partnership interest.[44] If a partner has made contributions of deferred gains as well as other money (or property), a distribution must be allocated between the two contributions based on the amount contributed.[45] As a result, a partner in a QOF partnership cannot avoid an inclusion event for its investors by designating the distribution as having made only with respect to the non-QOF investment. If a partnership

holds a QOF partnership interest, a distribution of property with a fair market value in excess of basis will be an inclusion event only if it is included in a liquidating distribution of the distributee partnership.[46]

X. Basis Increases in QOF Investments Resulting from Inclusion Events

The Treasury Department and the IRS received many comments requesting clarification as to how the 10-year basis adjustment should be made if a taxpayer disposes of less than all of its qualifying QOF stock or if less than all of its qualifying QOF stock is redeemed by the QOF corporation. The Final Regulations address this concern and provide that if a shareholder of a QOF corporation sells less than all of its qualifying QOF stock, the basis increase should be made only to those specific shares that are sold.[47] The Final Regulations also clarify that the five-year and seven-year basis adjustments to qualifying investment in a partnership or S corporation create a basis for all purposes of the Code, including for purposes of suspended losses under Code §§ 704(d) and 1366(d).[48]

The prior proposed regulations provided that if an S corporation is an investor in a QOF, the S corporation must adjust the basis of its qualifying investment in the manner set forth for C corporations, except as otherwise provided in the proposed regulations. In addition, the prior proposed regulations made clear that any adjustment to the basis of an S corporation's qualifying investment will not (i) be separately stated under Code § 1366 and (ii) adjust the shareholder's stock basis under Code § 1367 until the date on which an inclusion event with respect to the S corporation's qualifying investment occurs. The Final Regulations adopt these rules without modification.[49]

XI. Special Rules for Mixed Funds

As in the case of the prior proposed regulations, the Final Regulations continue to bifurcate a mixed-funds investment in a QOF partnership into a qualifying investment and a non-qualifying investment for purposes of QOF rules.[50] Any allocations of income or other tax items will be made to a mixed-funds partner based on the relative capital contributions attributable to the qualifying portion and non-qualifying portion of the investment. The Final Regulations also confirmed that deemed contributions resulting from section 752(a) adjustments do not generally create mixed-funds investments.[51] In the case of a partner who receives a profits interest for services as part of a mixed-funds investment, the allocation percentage of the profits interest will continue to be determined based on the share of residual profits that the mixed-funds partner would receive from the partnership, disregarding any allocation of residual profits for which there is not a reasonable likelihood of application.[52] In the case of a QOF corporation, the Final Regulations confirmed that a contribution with no corresponding receipt of stock will also result in a mixed-funds investment,[53] but the IRS declined to provide any additional details as to how the basis or other tax items should be allocated in such a case at this time.

XII. Dispositions and Reinvestments of QOF Investments

When an investor in a QOF partnership disposes of his partnership interest 10 years or more from the date she acquired such interest, the basis in such interest is stepped up to the sum of the fair market value of such interest plus the investor's share of partnership debt.[54] As a compliance matter, it should be noted that the basis step-up is not automatic, but the investor elects such

treatment by attaching a form to her tax return.[55] Furthermore, the election to step-up basis is not affected by a subsequent decertification of a census track as not qualifying as a qualified opportunity zone.[56]

In at least one area in the Final Regulations, the IRS played the Grinch. Taxpayers had hoped that the IRS would allow taxpayers who disposed of QOF interests, but acquired new QOF interests within a relatively short period of time, to tack the holding period of the old QOF interests to the new interests for purposes of the five-year, seven-year and 10-year basis adjustments. Unfortunately, the IRS refused to issue a rule permitting such tacking of holding periods.[57] Importantly, however, inclusion events that result from partnership distributions that do not terminate a taxpayer's interest in a QOF do not affect the investor's ability to claim basis step-ups for the remaining QOF investment.[58]

Prior to the issuance of the Final Regulations, there was uncertainty as to whether the basis adjustment and gain exclusion under Code § 1400Z-2(c) was available for 10-year or later dispositions of interests in qualified opportunity zone businesses ("QOZBs") or only dispositions of QOF interests. This uncertainty prevented certain taxpayers from forming multiple asset QOFs because of the issues presented by attempting to dispose of multiple assets or businesses at once. The Final Regulations permit QOF dispositions of less than all of the QOZB assets it holds, undertaken at least 10 years or after acquisition, to qualify for the full basis adjustment.[59]

The Final Regulations significantly expand the rules under the proposed regulations for gain exclusion for asset sales by QOFs and QOZBs. Specifically, the Final Regulations permit a taxpayer that invests in a QOZ partnership or QOF S corporation to make an election for each taxable year to exclude a QOF's gains and losses from all sales or exchanges in the taxable year, instead of just capital gains and losses.[60] The only exception is for gains or losses from the sale of inventory by the QOF in the ordinary course of business.[61] This election may be made regardless of whether the taxpayer has made an election for any prior taxable year.[62] In order to prevent the duplication of the tax benefits provided by the 10-year basis step-up, and solely for purposes of determining the amount of a QOF's qualifying investment and non-qualifying investment, the Final Regulations treat QOFs and investors electing to take advantage of this rule as making a deemed distribution and recontribution of net proceeds from the asset sales on the last day of the QOF's taxable year.[63]

XIII. Ongoing Compliance – Asset Valuation

A QOF is required to maintain an average of 90% of its assets in qualified opportunity zone property (the 90% investment standard).[64] For purposes of measuring compliance with the 90% investment standard, the Final Regulations provide that a QOF may value its assets using one of two methods on a semiannual basis, but the QOF must consistently apply the same valuation method to all assets with respect to the taxable year.[65] Taxpayers requested that the Final Regulations include a grace period for the QOF's first year, but the IRS declined to adopt this suggestion noting that the Code requires that the 90% investment standard be satisfied for each taxable year of the QOF's existence.

Consistent with the prior proposed regulations, a QOF may exclude certain recently contributed property from both the numerator and denominator of the test for six months. Certain requirements must be met in order for a QOF to avail itself of this exception, including that the amount of the contributed property be continuously held in cash, cash equivalents or

debt instruments with a term of 18 months or less. The rules leave some uncertainty as to whether a QOF that excludes all of its property from the calculation as recently contributed property, resulting in a fraction of zero over zero, satisfies the 90% investment standard. The preamble of the Final Regulations acknowledges that taxpayers raised concerns about a zero numerator and denominator resulting in an undefined mathematical result, but the IRS declined to make any changes in this regard. In a welcome addition, a QOF generally has five days to exchange any non-cash contributions for eligible cash or cash equivalent property.

The Final Regulations provide a safe harbor for QOFs to determine whether equity in an entity (i.e., QOF stock or interests in a QOF partnership) is qualified opportunity zone property as of the QOF's testing dates, which may not correspond to the taxable year of the entity. Under the Final Regulations, a QOF can include the equity of a QOZB in both the numerator and denominator of the 90% investment standard calculation if the entity was a QOZB for at least 90% of the QOF's cumulative holding period of the entity beginning on the effective date of the QOF's self-certification and ending on the last day of the entity's most recent taxable year ending on or before the semiannual testing date.[66] The Final Regulations also provide a cure period, which, if satisfied, allows the QOF to treat the QOZB as qualifying even if it did not qualify as of the end of its taxable year ending on or before a semiannual testing date.

Consistent with the proposed regulations, the Final Regulations outline two methods for valuing assets for purposes of the 90% investment standard: the applicable financial statement valuation method and the alternative valuation method. Under the applicable financial statement valuation method, the value of each property owned or leased by the QOF is the value of the property as reported on the QOF's applicable financial statement for the testing period.[67] Under the alternative valuation method, the value of each property owned by a QOF is the QOF's unadjusted cost basis of the asset. While the proposed regulations applied this rule generally to all owned property, the Final Regulations clarify that unadjusted cost basis is only applicable to property acquired by purchase or constructed for fair market value; assets not purchased or constructed for fair value are valued at fair market value.[68] Leases under the alternative valuation method are valued at the sum of the present values of each payment under the lease at the time the QOF enters into the lease.[69] The Final Regulations specify that the short-term AFR must be used as the discount rate for purposes of calculating the present value of a lease.[70] The Final Regulations also specify that transparent entities, such as qualified subchapter S subsidiaries, grantor trusts, and disregarded entities are not treated as QOZBs, but the assets of the transparent entities are treated as assets of the QOF for purposes of the 90% investment standard.

Despite taxpayer request, the IRS declined to adopt a wind-down safe harbor period to provide relief during the end of a QOF's life when the QOF may be disposing of qualified QOZB property in exchange for cash or other non-qualifying property. The preamble noted that although the IRS understood the policy arguments for a wind-down period, it could potentially encourage QOF dissolutions, which would be in contrast to the policy goals of Code § 1400Z-2.

XIV. Inventory as QOZB Property

The prior proposed regulations raised many questions as to whether inventory should be treated as qualified opportunity zone business property for purposes of the 90% investment standard and the 70% tangible property standard. The Final Regulations offer taxpayers

some flexibility in meeting the standards with regard to inventory. In determining whether the 90% investment standard and the 70% tangible property standard are satisfied, a QOF or a QOZB may choose to include the value of all inventory, including raw materials, in both the numerator and the denominator of the tests, or exclude the value of all inventory from both the numerator and the denominator of the tests.[71] The QOF or QOZB must apply the choice consistently with regard to all semiannual tests throughout the period where the QOF holds the inventory.[72]

Many commenters requested clarification regarding the treatment of inventory in transit for purposes of this 70% use test. The Final Regulations adopt the inventory in transit safe harbor that was introduced in the prior proposed regulations, which provided that the inventory, including raw materials, in transit will be deemed to be used in a QOZ if the inventory is in transit either from a vendor to a facility of the trade or business that is in a QOZ or from a facility of the trade or business that is in a QOZ to customers outside the QOZ.[73] The Final Regulations also provide that neither the distance traveled in the course of the transit of the inventory nor the fact that the inventory is briefly stored in a warehouse during transit would affect the application of the inventory transit safe harbor.[74]

XV. The "Substantially All" Requirements

The phrase "substantially all" appears five times in the QOF tax statute. In the prior proposed regulations, the IRS assigned the phrase different meanings depending on the context in which it was used. The Final Regulations continue to use different standards in determining whether a transaction satisfies the various requirements.

First, the Final Regulations continue to require that qualified opportunity zone stock, partnership interests and property be treated as such during at least 90% of the QOF's holding period in order for the QOF to generate tax benefits for the investor.[75] Second, property held by a QOZB (the lower-tier partnership described above) will count towards satisfaction of QOZB qualification only if it is treated as such for 90% of its holding period by the QOF or (lower tier) QOZB partnership or corporation. The Final Regulations offer a safe-harbor under which use is tested from the beginning of the holding period of the asset until the last day of the preceding year.[76] Otherwise, testing occurs semi-annually.[77] In addition, the Final Regulations offer a six-month cure period for asset use failures.

Third, "substantially all" of the use of tangible property must occur in an opportunity zone in order for the property to be treated as QOZB property.[78] The Final Regulations retain the 70% use standard and provide detailed rules for mobile property and property leased by a QOZB that is used by the lessee outside of the QOZB.[79] In general, the 70% test is measured by day count during each testing period.[80] As a general rule, property is used in a QOZB if it is located in an opportunity zone in connection with the ordinary conduct of a trade or business. In addition, if property is used in more than one opportunity zone, the use of all opportunity zones are aggregated in determining if the 70% standard is met.

Last, "substantially all" of the tangible property held by a business must be QOZB property in order for the QOZB to be treated as such. The Final Regulations retain the rule that at least 70% of the tangible property owned or leased by a business be QOZB property in order for the business to be treated as a QOZB.[81]

XVI. Original Use Determination

The Code requires either that the original use of the QOZB property in the QOZ commences with

the QOF or QOZB or that the QOF or QOZB substantially improve the property.[82] The prior proposed regulations generally provided that the "original use" of tangible property acquired by purchase commences on the date on which that person or a prior person (i) first places the property in service in the QOZ for purposes of depreciation or amortization or (ii) first uses the property in the QOZ in a manner that would allow depreciation or amortization if that person were the property's owner. [83] Property previously used in a QOZ does not satisfy the original use requirement.

The preamble explains that the construction of new buildings in economically disadvantaged communities, which are required for the purpose of introducing new businesses into such communities, clearly achieves the policy goals underlying the QOF rules and should be encouraged. Accordingly, the Final Regulations provide an example that provides certainty with regard to the acquisition of such newly constructed buildings.[84]

The prior proposed regulations provided that, if property has been unused or vacant for an uninterrupted period of at least five years, original use in the QOZ commences on the date after that period when any person first so uses or places the property in service in the QOZ. The Final Regulations modify this proposed five-year vacancy requirement. Specifically, the Final Regulations provide a special one-year vacancy requirement for property that was vacant prior to and on the date of the publication of the QOZ designation notice that listed the designation of the QOZ in which the property is located, and through the date on which the property was purchased by an eligible entity.[85] With respect to property not vacant as of the time of such QOZ designation notice but that later becomes vacant, the Final Regulations require the property to be vacant continuously for at least three years.[86]

In addition, the Final Regulations provide a definition for the term "vacant." Under the Final Regulations, real property, including land and buildings, is considered to be in a state of vacancy if the property is "significantly unused."[87] A building or land will be considered to be "significantly unused" under the final regulations if more than 80% of the building or land, as measured by the square footage of useable space, is not being used.[88]

The Final Regulations also provide that an eligible entity that purchases real property from a local government that the local government holds as the result of an involuntary transfer (including through abandonment, bankruptcy, foreclosure, or receivership) may treat all property composing the real property (including the land and structures thereon) as satisfying the original use requirement.[89]

XVII. The Substantial Improvement Requirement

The QOF rules treat certain rehabilitated tangible property as QOZB property (if it is acquired after December 31, 2017 from an unrelated person).[90] The Final Regulations continue to apply the rules contained in the prior proposed regulations. Specifically, used tangible property will be treated as QOZB property provided that the improvements made to such property over any 30-month period exceed the basis in the property at the beginning of the 30-month period.[91] Property that is undergoing renovation will be treated as QOZB property during the 30-month renovation period, provided that is has not yet been placed in service.[92] An aggregation rule will make satisfaction of the substantial improvement test easier for many taxpayers. Specifically, a taxpayer may treat the cost of purchased property that would otherwise by QOZB property as an improvement if three requirements are met. Specifically, the purchased property must be located in the opportunity zone as the property being

renovated, be used in the same trade or business and improve the functionality of the property being improved.[93] In an example, the IRS allowed the costs of linens and other furnishings by a QOZB renovating a hotel to count towards the substantial improvement requirement. In addition, certain contiguous buildings may be aggregated in determining if all of them have been substantially improved.[94] Raw land, provided it is not just being banked, is exempt from the substantial improvement requirement.[95]

XVIII. 50% Gross Income Requirements

In order for a partnership or a corporation to qualify as a QOZB, such entity must derive at least 50% of its total income from the active conduct of a trade or business within a QOZ.[96] The Final Regulations adopted safe harbors introduced in the prior proposed regulations for purpose of this 50% gross income test, but also made a few helpful clarifications.

First, the Final Regulations clarified that for purposes of this 50% gross income test, gross income will be aggregated from all activities of a trade or business carried out among all QOZs in which such trade or business operates.[97] For example, the prior proposed regulations provided that the 50% gross income requirement will be deemed satisfied if at least 50% of the services performed for the trade or business are performed in an opportunity zone based on the total number of service hours or the amount paid as compensation. The Final Regulations confirmed that for this purpose, the services performed by partners of a partnership (and guaranteed payments for services) will be taken into account.[98] In addition, the preamble to the Final Regulations explained that any such services provided by an independent contractor or its employees will be disregarded if such services were not performed for the QOZB. This clarification should make the service-hours test much more useful.

Alternatively, a trade or business can satisfy the 50% gross income test if (i) the tangible property of the trade or business located in an opportunity zone and (ii) the management or operational functions performed in the opportunity zone are both necessary for the generation of at least 50% of the gross income of the trade or business. The Final Regulations kept this safe harbor without much modification, acknowledging that the applicability of this test in the context of those businesses with non-conventional management and operational structures is not entirely certain and needs to be further studied.

XIX. Limitation on Nonqualified Financial Property

A QOZB cannot own 5% or more of nonqualified financial property ("NQFP"). NQFP generally includes, among others, debt, stock, partnership interests, options, or other similar properties other than certain qualified working capital. The Final Regulations adopted the prior proposed regulations on this point without much modification. Particularly, commentators have requested that this NQFP test should be performed on a group-wide basis when a QOZB is structured through tiered entities ignoring any stock or partnership interest held by upper-tier entities. The Final Regulations did not accept this comment.

XX. Reinvestment

Proposed regulations has provided that if a QOF reinvests the proceeds from the sale of a qualified opportunity property within 12 months of the sale, then the proceeds will be treated as qualified opportunity zone property for purposes of testing QOF's 90% asset test.

For this purpose, the Final Regulations provide additional relief in case of a federally declared natural disaster, in which case, the 12-month period may be extended up to 24 months, provided that the QOF must invest the proceeds as originally planned before the disaster.[99] However, this reinvestment exception does not prevent any gain recognition on the underlying sale. Therefore, a partner in a QOF will have to recognize its share of any gain on the sale, even if the sales proceeds are considered as qualified opportunity zone property under this reinvestment exemption. In addition, this reinvestment exception does not apply to a QOZB. Therefore, if a QOZB sells its assets, the proceeds will count against satisfactions of the 70% asset test, unless such proceeds are treated as good working capital of the QOZB.

XXI. Intangibles

Many businesses produce, own and utilize a significant amount of intangible property. A QOZB is required to use a substantial portion of its intangible property in the active conduct of a trade or business within the QOZ (the intangible property use test).[100] The term "substantial portion" means at least 40% of the intangible property of the QOZB in this context.[101] For purposes of the intangible property use test, the active conduct of trade or business includes the ownership and operation (including leasing) of real property.[102]

The Final Regulations clarified the meaning of "use" and the location of the use for purposes of the intangible property use test. The intangible property of a QOZB is deemed to be used in the active conduct of a trade or business in a QOZ if the use of the intangible property is normal, usual or customary in the conduct of the trade or business.[103] Additionally, the intangible property must be used in the QOZ in the performance of an activity of the trade or business that contributes to the generation of gross income for the trade or business.[104]

The QOZ rules governing intangible property incorporate by reference the rules applicable to empowerment zones.[105] The empowerment zone rules provide that an intellectual property holding company, which predominantly engages in the trade or business of developing or holding intangible property for sale or license, would not be a qualified business eligible for the empowerment zone treatment.[106] Responding to comments, the Final Regulations state that an intellectual property holding company as such would not qualify as a qualified opportunity zone business.[107]

XXII. Trade or Business

Commentators noted that the rules for start-up businesses were not addressed by the prior proposed regulations. In response, the IRS created an additional 62-month safe harbor for start-up businesses. As set forth in the Final Regulations, the 62-month working capital safe harbor provides that, during the maximum 62-month covered period, (1) nonqualified financial property in excess of the 5% nonqualified financial property limitation will not cause a trade or business to fail as a QOZB and (2) gross income earned from the trade or business will be counted towards satisfying the 50-percent gross income requirement (each of clauses (1) and (2) function in a manner similar to the 31-month working capital safe harbor).[108] In addition, the 62-month working capital safe harbor provides that, during the maximum 62-month covered period, (i) tangible property purchased, leased, or improved by a business with cash covered by a working capital safe harbor, pursuant to the plan submitted with respect to that safe harbor, will count towards satisfaction of the 70% tangible property standard and (ii) intangible property purchased or licensed with that cash, and pursuant to that plan, likewise will count towards the satisfaction of the 40% intangible property use test.[109]

A start-up business must receive multiple cash infusions during its start-up phase to qualify for a maximum 62-month safe harbor. Specifically, under the 62-month working capital safe harbor, a start-up business can qualify for a 31-month safe harbor period with respect to the business's first cash infusion. Upon receipt of a subsequent contribution of cash, the business can both (i) extend the original 31-month safe harbor period that covered the initial cash infusion and (ii) receive safe harbor coverage for the subsequent cash contribution for another maximum 31-month period if the business satisfies the following two conditions. First, the subsequent cash infusion must be independently covered by an additional working capital safe harbor. Second, the working capital safe harbor plan for the subsequent cash infusion must form an integral part of the working capital safe harbor plan that covered the initial cash infusion.

To ensure the proper application of the 62-month working capital safe harbor, the Final Regulations provide additional operating rules. For example, the Final Regulations make clear that, regardless of the number of subsequent cash infusions, the 62-month working capital safe harbor cannot extend past the 62-month period beginning on the date of the first cash infusion covered by the safe harbor. In addition, the 62-month working capital safe harbor features a minimum investment threshold for each subsequent cash infusion to ensure that a *de minimis* subsequent infusion does not unlock a subsequent 31-month period for previously covered tangible and intangible property.

The proposed regulations provided that triple-net-leasing was not a trade or business that could be treated as a QOZB. The Final Regulations confirm that merely entering into a triple-net-lease with respect to real property owned by a taxpayer does not constitute the active conduct of a trade or business by such taxpayer.[110] To illustrate the application of this rule, the Final Regulations set forth examples describing a triple-net-lease as a lease arrangement pursuant to which the tenant is responsible for all of the costs relating to the lease property in addition to paying rent. In an instance in which the taxpayer's sole business consists of a single triple-net-lease of a property, the Final Regulations confirm that the taxpayer does not carry out an active trade or business with respect to that property solely for purposes of Code § 1400Z-2(d)(3)(A).[111]

However, the Final Regulations acknowledge that, in certain cases, a taxpayer that utilizes a triple-net-lease as part of the taxpayer's leasing business could be treated as conducting an active trade or business solely for QOF purposes. Specifically, the Final Regulations provide an example in which a lessor leases a three-story mixed-use building to three tenants, each of which rents a single floor.[112] In that example, (i) the lessor leases one floor of the building under a triple-net-lease but leases the remaining two floors under leases that do not constitute triple-net-leases, and (ii) the employees of the lessor meaningfully participate in the management and operations of those two floors.[113] As a result, the example provides that the lessor is treated as carrying out an active trade or business with respect to the entire leased building.[114]

The Final Regulations also include rules for self-constructed property. Under the Final Regulations, tangible property is not disqualified from constituting QOZB property solely because it is manufactured, constructed, or produced, rather than purchased, by a QOF or QOZB.[115] However, in order to qualify as QOZB property, the property must be constructed with the intent to use the property in a trade or business in a QOZ, and the materials and supplies used in construction must be QOZB property.[116] Self-constructed property will be treated as acquired on the date physical work of a significant nature begins.[117]

XXIII. Projects That Straddle a QOF

Under circumstances in which a business owns real property that is located in more than one census tract, only one of which is a QOZ, the proposed regulations provided that if (i) the amount of real property based on square footage located within the QOZ is substantial as compared to the amount of real property based on square footage outside of the QOZ ("square footage test") and (ii) the real property outside of the QOZ is contiguous to part or all of the real property located inside the QOZ, then all of the property is deemed to be located within a QOZ. However, the preamble to the proposed regulations set forth an unadjusted cost test, rather than the square footage test, to determine whether property that straddles QOZ and non-QOZ census tracts would be treated as located within a QOZ. The Final Regulations have been revised to allow taxpayers to use either a square footage test or the unadjusted test to determine if the subject property is located substantially within a QOZ when property straddles QOZ and non-QOZ census tracts.[118]

The Final Regulations clarify and define contiguous property. Specifically, the Final Regulations provide that parcels or tracts of land will be considered contiguous if they possess common boundaries, and would be contiguous but for the interposition of a road, street, railroad, stream or similar property.[119] In addition, the Final Regulations exclude from the definition of the term "common boundaries" boundaries of parcels of land that touch only at a common corner.[120]

XXIV. Rules for QOFs Operating in Territories

The Final Regulations continue to reflect a bias against QOFs organized in US territories that was presaged by the prior proposed regulations. An entity organized in a territory can be a QOF provided that it conducts a business in the territory in which it is organized.[121] On the other hand, a QOF organized within the United States can conduct a QOZB in opportunity zones located in territories and well as in the United States.

XXV. Anti-Abuse Rules

The Final Regulations provide a definition of the purpose of the QOZ rules: "[T]o provide federal income tax benefits to owners of QOFs to encourage the making of long-term investments . . . of new capital in one or more qualified opportunity zones and to increase the economic growth of such qualified opportunity zones."[122] The Final Regulations contain a general anti-abuse rule that allows the IRS to deny benefits to persons whose investments are inconsistent with this objective.

The Final Regulations contain a special anti-abuse rule aimed at preventing non-US persons from converting gains that would not be eligible for a QOF investment into eligible gains.[123] If a partnership is formed or availed of to allow non-US persons to make QOF investments with respect to gains that are not subject to US tax in their hands, the contribution by the partnership will not be considered to have been made with eligible gains. An example concludes that the anti-abuse rule is triggered when non-US persons contribute appreciated property to a QOF with a view towards the disposition of such property and the contribution of the gain to a QOF.

XXVI. Coordination with Consolidated Return Rules

In response to numerous commenters, the rules regarding the federal income tax treatment of QOFs owned by members of consolidated groups have been radically changed. The Final Regulations permit the

consolidation of a subsidiary QOF C corporation if certain conditions are satisfied. Specifically, except in very limited circumstances and consistent with the general principles of Code § 1400Z-2, the consolidated group member that makes the qualifying investment in the QOF member ("QOF investor member") must maintain a direct equity interest in the QOF member. In addition, the Final Regulations require all QOF investor members to be wholly owned, directly or indirectly, by the common parent of the consolidated group.

The Final Regulations add special rules that coordinate the application of the consolidated return provisions and the QOF rules by imposing restrictions on the application of the full range of consolidated return rules. The Final Regulations include a rule under which the QOF investor member must take its excess loss account ("ELA") into account pursuant to Treasury Regulation § 1.1502-19 before its basis in the QOF member stock is adjusted to fair market value under the QOF rules.[124]

The Final Regulations also include a rule to determine when a distribution by a QOF member to the QOF investor member constitutes an inclusion event. Generally, a distribution by a QOF C corporation is an inclusion event to the extent Code § 301(c)(3) applies to the distribution. In order to coordinate the application of the QOF and the consolidated return rules, the Final Regulations provide that a distribution by a QOF member to a QOF investor member is an inclusion event to the extent the distribution otherwise would create or increase an ELA in the QOF member stock.[125]

In addition, the Final Regulations include a rule for computing the amount includible by an investor member upon the occurrence of an inclusion event. Generally, the amount of deferred gain includible in income is determined by reference to the investor's basis in the qualifying investment. However, when a subsidiary QOF C corporation is a member of a consolidated group, Treasury Regulation § 1.1502-32 applies to adjust the QOF investor member's basis in the stock of the QOF member to reflect the QOF member's income, gain, deduction, or loss.

The Final Regulations also include a rule applicable to transactions between the QOF's separate affiliated group ("QOF SAG") and other members of the consolidated group. A QOF SAG is, with respect to a QOF member, the affiliated group that would be determined under Code § 1504(a) if the QOF member were the common parent.[126] Under the Final Regulations, a sale or exchange of property between a QOF SAG member and a member of the consolidated group that is not a member of such QOF SAG is treated as a transaction that is not an intercompany transaction.[127] Conversely, transactions between QOF SAG members, and transactions between a QOF SAG member and a member of the consolidated group that is not a member of such QOF SAG other than a sale or exchange of property, are intercompany transactions that are subject to the rules of Treasury Regulation § 1.1502-13.[128]

Additionally, the Final Regulations provide that a consolidated group is not treated as a single entity for purposes of determining whether a QOF member or a QOZB satisfies the investment standard rules for QOFs. Instead, these rules generally apply separately to each consolidated group member that is a QOF or QOZB.[129]

Under the Final Regulations, a pre-existing QOF subsidiary may elect to be reclassified as a QOF partnership, a QOF C corporation that is not a member of the consolidated group or a member of the consolidated group that is not a QOF.[130] A reclassification election is effective as of the first day the pre-existing QOF subsidiary was acquired or formed by members of the consolidated group.[131] In addition, if a pre-existing QOF subsidiary was

a QOF C corporation before being acquired by a consolidated group, and if the consolidated group elects to treat the pre-existing QOF subsidiary as a QOF partnership as of the date it was acquired by the group, the conversion from a QOF C corporation to a QOF partnership on that day is an inclusion event.[132]

An investment of eligible gain by the QOF investor member into a QOF member is not treated as an intercompany transaction for purposes of Treasury Regulation § 1.1502-13 and, therefore, is a qualifying investment for QOF purposes. When a member sells property to another member of the consolidated group and recognizes gain, the gain is an intercompany gain subject to Treasury Regulation § 1.1502-13. The Final Regulations provide clarification that the selling member's gain and buying member's gain on the property, if any, are treated as eligible gains to the extent the gain would be an eligible gain if each member were divisions of a single entity.[133] Moreover, the gain is treated as an eligible gain at the time the gain would be taken into account if each member were divisions of a single entity.[134]

An election to treat the investment by one member as a qualifying investment by another member is also available under the Final Regulations. The election is available when one member has an eligible gain and the other member make an investment in a QOF that would be a qualifying investment if the former member had made the investment.[135] If the consolidated group makes this election, for all federal income tax purposes, the member with the eligible gain is treated as making an investment in the QOF and immediately selling the qualifying investment to the other member for fair market value.[136]

The Final Regulations also contain an anti-avoidance rule, which provides that, if a transaction is structured with a view to avoiding the application of the rules of Code § 1400Z-2 and the regulations thereunder or the consolidated return regulations, appropriate adjustments will be made to carry out the purposes of Code § 1400Z-2 and the regulations thereunder.[137]

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Endnotes

[1] The authors are all tax lawyers with the law firm of Mayer Brown.

[2] T.D. 9889 (December 19, 2019).

[3] REG-115420-18 (Dec. 2018) and REG-120186-18 (Apr. 2019). For coverage of the prior proposed regulations please see https://www.mayerbrown.com/en/perspectives-events/publications/2018/10/just-released-irs-qualified-opportunity-fund-guida and https://www.mayerbrown.com/en/perspectives-events/publications/2019/04/mayer-brown-analyzes-second-set-of-qualified-opportunity-fund-regulations.

[4] See Treas. Reg. § 1.1400Z2(a)-1(g)(1).

[5] Treas. Reg. § 1.1400Z2(a)-1(g)(2).

[6] H.R. 115-__, 115th Cong., 1st Sess. 398 (2017). Commentators have raised questions as to whether the legislation is well-suited to its purpose. *See* https://www.nytimes.com/2019/11/16/opinion/trump-tax-opportunity-zones.html.

See also Treas. Reg. § 1.1400Z2(f)-1(c).

[7] IRS Notice 2018-48.

[8] Treas. Reg. § 1.1400Z2(b)-1(g)(4)(ii).

[9] Rev. Rul. 70-598, 1970-2 CB 168.

[10] Code § 1400Z-2(a)(1)(A).

[11] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iii).

[12] Treas. Reg. § 1.1400Z2(a)-1(b)(7).

[13] Treas. Reg. § 1.1400Z2(a)-1(b)(11).

[14] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(v).

[15] Treas. Reg. § 1.1400Z2(f)-1(c)(1).

[16] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iii)

[17] Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)

[18] Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(B)

[19] Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(C)

[20] Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(C)

[21] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii)(B)

[22] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii)(A)

[23] Treas. Reg. § 1.1400Z2(a)-1(b)(7)(iii)(B)

[24] *Id.*

[25] *Id.*

[26] *See* Treas. Reg. § 1.1400Z2(b)-1(c)(15).

[27] Treas. Reg. § 1.1400Z2(d)-1(a)(2)(iii).

[28] *Id.*

[29] Treas. Reg. § 1.1400Z2(d)-1(b)(2).

[30] Treas. Reg. § 1.1400Z2(d)-1(b)(3).

[31] Treas. Reg. § 1.1400Z2(d)-1(b)(4).

[32] Treas. Reg. § 1.1400Z2(a)-1(b)(12).

[33] Treas. Reg. § 1.1400Z2(a)-1(b)(11).

[34] Code § 1445(a); Treas. Reg. § 1.1445-1(b) (Generally the withholding is 15% of the amount realized, but it is reduced to 10% for dispositions of residences with a sales price of $1 million or less. No withholding is required by persons who acquire a residence for less than $300,000. Treas. Reg. § 1.1445-2(d)(1).) The IRS can issue a "withholding certificate" that reduces the amount required to be withheld. Treas. Reg. § 1.1445-3. The withholding certificate process takes 90 days. *Id.*

[35] Code § 897(e); Temp. Treas. Reg. 1.897-6T.

[36] Treas. Reg. § 1.1400Z2(a)-1(e).

[37] Treas. Reg. § 1.400Z2(b)-1.

[38] Treas. Reg. § 1.1400Z2(b)-1(g)(2).

[39] Treas. Reg. § 1.1400Z2(b)-1(c)(1).

[40] Treas. Reg. § 1.1400Z2(b)-1(c)(2) – (15). Numerous inclusion event rules are specified for QOF corporations. This Legal Update does not discuss such rules.

[41] Treas. Reg. § 1.1400Z2(b)-1(c)(6).

[42] Treas. Reg. § 1.1400Z2(b)-1(c)(6)(ii)(C).

[43] *See* Treas. Reg. § 1.1400Z2(b)-1(c)(2)(i).

[44] Treas. Reg. § 1.1400Z2(b)-1(c)(6)(iii).

[45] Treas. Reg. § 1.1400Z2(b)-1(c)(6)(iv).

[46] Treas. Reg. § 1.1400Z2(b)-1(c)(6)(iii).

[47] Treas. Reg. § 1.1400Z2(b)-1(g).

[48] Treas. Regs. §§ 1.1400Z2(b)-1(g)(4)(ii) and (g)(5)(i).

[49] Treas. Reg. § 1.1400Z2(b)-1(g)(5).

[50] 1.1400Z2(a)-1(c)(6)(iii)(B)(5)

[51] 1.1400Z2(a)-1(f)(2

[52] 1.1400Z2(b)-1(b)(6)(iv)(D)

[53] 1.1400Z2(a)-1(f)(3)

[54] Treas. Reg. § 1.1400Z(c)-1(b)(1)(v)(B).

[55] Treas. Reg. § 1.1400Z2(c)-1(b)(2)(ii)(D).

[56] Treas. Reg. § 1.1400Z2(c)-1(c).

[57] Treas. Reg. § 1.1400Z2(c)-1(b)(1)(i).

[58] Treas. Reg. § 1.1400Z2(c)-1(b)(1)(v).

[59] Treas. Reg. § 1.1400Z2(c)-1(b)(2)(ii).

[60] Treas. Reg. §1.1400Z2(c)-1(b)(2)(ii)(A).

[61] *Id.*

[62] *Id*.

[63] Treas. Reg. §1.1400Z2(c)-1(b)(2)(ii)(B)(1).

[64] Code §1400Z-2(d)(1).

[65] Treas. Reg. §1.1400Z2(d)-1(b)(2).

[66] Treas. Reg. §1.1400Z2(d)-1(b)(2)(i)(C).

[67] Treas. Reg. §1.1400Z2(d)-1(b)(3).

[68] Treas. Reg. §1.1400Z2(d)-1(b)(4).

[69] *Id*.

[70] *Id*.

[71] Code § 1400Z-2(d)(2)(B)(2)(iii).

[72] *Id*.

[73] Treas. Reg. § 1.1400Z2(d)-2(d)(4)(viii).

[74] *Id*.

[75] *See* Code § 1400Z-2(D)(2)(b)(i)(III) (stock); Code § 1400Z-2(d)(2)(C)(iii) (partnership interests); Code § 1400Z-2(d)(2)(i)(III) (QOZBs).

[76] Treas. Reg. § 1.1400Z2(d)-1(c)(2)(C)(1) (stock).

[77] Treas. Reg. § 1.1400Z2(d)-1(c)(2)(C)(2) (stock).

[78] Code § 1400Z-2(c)(2)(D)(i)(III).

[79] Treas. Reg. § 1.1400Z2(a)-1(b)(3).

[80] Treas. Reg. § 1.1400Z2(d)-2(d)(4)(ii).

[81] Treas. Reg. § 1.1400Z2(a)-1(b)(2); Treas. Reg. § 1.1400Z(d)-1(d)(2)(i).

[82] Code § 1400Z-2(d)(2)(D).

[83] Treas. Reg. § 1.1400Z(d)-2(b)(2).

[84] Treas. Reg. § 1.1400Z(d)-2(b)(3)(D).

[85] Treas. Reg. § 1.1400Z(d)-2(b)(3)(B).

[86] *Id*.

[87] Treas. Reg. § 1.1400Z(d)-2(b)(3)(iii).

[88] *Id*.

[89] Treas. Reg. § 1.1400Z(d)-2(b)(3)(iv).

[90] Code § 1400Z-2(c)(2)(D)(i)(II).

[91] Treas. Reg. § 1.1400Z2(d)-2(b)(4)(i).

[92] Treas. Reg. § 1.1400Z2(d)-2(b)(4)(ii).

[93] Treas. Reg. § 1.1400Z2(d)-2(b)(4)(iii).

[94] Treas. Reg. § 1.1400Z2(d)-2(b)(4)(v).

[95] Treas. Reg. § 1.1400Z2(d)-2(b)(4)(iv)(B).

[96] Code § 1400Z-2(d)(3)(A)(ii), 1397C(b)(2).

[97] Code § 1.1400Z1(d)-1(d)(3)(i)

[98] Code § 1.1400Z1(d)-1(d)(3)(i)(A)

[99] Code § 1.1400Z2(f)-1(b)(2)

[100] Code § 1400Z-2(d)(3)(A)(ii).

[101] Treas. Reg. § 1.1400Z2(d)-1(c)(3)(ii)(A).

[102] Treas. Reg. § 1.1400Z2(d)-1(c)(3)(iii).

[103] Treas. Reg. § 1.1400Z2(d)-1(c)(3)(ii)(B).

[104] *Id.*

[105] Code § 1400Z-2(d)(3)(A)(ii).

[106] Code § 1397C(d)(4).

[107] T.D. 9889 (December 19, 2019).

[108] Treas. Reg. § 1.1400Z2(d)-1(d).

[109] *Id.*

[110] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(iii)(B).

[111] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(iii)(C)(1).

[112] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(iii)(C)(2).

[113] *Id.*

[114] *Id*

[115] Treas. Reg. §1.1400Z2(d)-2(b)(1)(iii)(A).

[116] *Id.*

[117] Treas. Reg. §1.1400Z2(d)-2(b)(1)(iii)(B).

[118] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(ix).

[119] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(ix)(F).

[120] *Id.*

[121] Treas. Reg. § 1.1400Z2(d)-1(a)(1)(ii)(B). Land banking refers to the practice of holding land primarily for speculative purposes and without an intention to develop a trade or business on that land. In an example, the IRS concluded that the operation of a parking lot was land banking when a significant purpose of the holding of the land was for speculative purposes. *See* Treas. Reg. § 1.1400Z2(f)-1(c)(3)(Ex. 6).

[122] Treas. Reg. § 1.1400Z2(f)-1(c).

[123] Treas. Reg. § 1.1400Z2(f)-1(c)(2)(ii).

[124] Treas. Reg. § 1.1502-14Z(b)(iii).

[125] Treas. Reg. § 1.1502-14Z(b)(1)(i).

[126] Treas. Reg. § 1.1502-14Z(a)(ii)(G).

[127] Treas. Reg. § 1.1502-14Z(b)(iv)(A).

[128] Treas. Reg. § 1.1502-14Z(b)(iv)(B).

[129] Treas. Reg. § 1.1502-14Z(b)(v).

[130] Treas. Reg. § 1.1502-14Z(f)(2)(ii).

[131] Treas. Reg. § 1.1502-14Z(f)(2)(ii)(B).

[132] *See* Treas. Reg. § 1.1400Z2(b)-1(c)(2).

[133] Treas. Reg. § 1.1502-14Z(c).

[134] *Id.*

[135] Treas. Reg. § 1.1502-14Z(h)(2).

[136] *Id.*

[137] Treas. Reg. § 1.1502-14Z(b)(v)(2).

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