



KPMG report: New rules for Opportunity Zones

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New IRS/Treasury rules add clarity for qualified opportunity zone investments

The IRS and Treasury recently issued additional guidance in the form of proposed regulations¹ for the new Opportunity Zone provisions under the 2017 Tax Cuts and Jobs Act.² Contemporaneous with the issuance of these proposed regulations, the IRS released separate guidance addressing how a building acquired on land is treated for purposes of satisfying the “original use” and the “substantial improvement” requirements to acquire qualified opportunity zone property.³

The proposed rules provide much needed clarity for taxpayers seeking to take advantage of investments in a Qualified Opportunity Fund (QOF) that allows gain deferral and potential exclusion of gains for investments in economically underserved areas across the nation, including U.S. possessions, and the District of Columbia.

This article summarizes the IRS/ Treasury guidance and offers KPMG observations as to how these rules may be applied in forming and investing in QOFs.

Current law

Under the Opportunity Zones provisions, a taxpayer who sells property to an unrelated person in a transaction that generates certain gains, may elect to invest all or a portion of the amount of those gains within 180 days into a QOF. The QOF then must invest the amount of those gains in qualified opportunity zone (QOZ) property. QOZ property includes QOZ stock, QOZ partnership interests, and QOZ business property.

To date, the Treasury has designated QOZs in all 50 states, US territories including American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands, and the District of Columbia.⁴

The taxpayer’s gain on the initial sale is deferred to the extent the gain is invested in the QOF within 180 days beginning on the date of the sale or exchange giving rise to the gain. The reinvested gains are deferred until the earlier of the date that: (i) the interest in the QOF is sold, or (ii) December 31, 2026. The amount of gain included in income is the excess of the lesser of the deferred gain or the fair market value of the investment over taxpayer’s basis in the investment. No election may be made for sales or exchanges if an election is in effect for such sale or exchange or for any sale or exchange after December 31, 2026.

¹ Proposed regulations under section 1400Z-2 of the Code that would amend the Income Tax Regulations (26 CFR Part 1). Section 13823 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2184 (2017) (TCJA)

² Section 1400Z, H. R. 1 -115th Congress (2017-2018)

³ Rev. Rul. 2018-29 (released October 19, 2018)

⁴ A complete list of designated qualified opportunity zones is found in Notice 2018-48, 2018-28 I.R.B. 9

Depending on the length of time the QOF investment is held, there is the potential for a permanent exclusion of the initially invested gains of up to 15%.⁵

The partial exclusion is achieved through the operation of the basis adjustment rules. Under these rules, the taxpayer's initial basis in the QOF is zero. If the investment is held for 5 years, the basis of the investment is increased by 10% of the deferred gain. If the investment is held for 7 years, the basis of the investment is increased by an additional 5% of the deferred gain for a total of a 15% basis increase.⁶

There is also a special gain exclusion for investments held for at least 10 years. If an investment is held at least 10 years, and, if the taxpayer so elects, the basis of the property is equal to the fair market value of the investment on the date that the investment is sold or exchanged. Consequently, gain upon the sale of a QOF investment held for at least 10 years in excess of the taxpayer's originally invested gains from the sale or exchange of an asset may be permanently excluded.

Proposed regulations

The proposed regulations clarify many of the above rules including:

Eligible gains –

Gain is eligible for deferral if it is treated as a capital gain for federal income tax purposes, including capital gain from an actual, or deemed, sale or exchange, or any other gain that is required to be included in a taxpayer's computation of capital gain. As such, short term and long term capital gains under section 1221 qualify.⁷

Observation 1: *Section 1231 gains are treated as long-term capital gains for a tax year if the section 1231 gains of a taxpayer exceed the section 1231 losses for the year, provided that section 1231(c) (related to recapture of net ordinary losses) does not apply. As such, it would appear that a taxpayer that would have recognized a long-term capital gain on the sale of section 1231 property for a year could treat that gain as an eligible gain. In addition, if this gain is an eligible gain, the fact that some or all of that gain is treated as unrecaptured section 1250 gain under section 1(h) should not change this eligible gain treatment.*

Observation 2: *Capital gain dividends and undistributed capital gains received by regulated investment company (RIC) and real estate investment trust (REIT) shareholders appear to be eligible gains with respect to those shareholders.⁸*

⁵ That permanent exclusion could be higher if the fair market value of the investment at the triggering date is less than the deferred gain.

⁶ Section 1400Z-2(b)(2)(B)

⁷ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(2).

⁸ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(4)(ii), Examples 2 and 3.

Note 1: The gain to be deferred must be gain that would be recognized, if deferral under section 1400Z-2(a)(1) were not permitted, not later than December 31, 2026, the final date under section 1400Z-2(a)(2)(B) for the deferral of gain.

Observation 1: *If gain realized for a tax year prior to 2027 is deferred under another provision of the Code or Regulations, the gain does not appear to be an eligible gain until it is otherwise recognized by the taxpayer. That gain recognition must occur prior to 2027 for the gain to be an eligible gain.*

Note 2: The sale or exchange must be with an unrelated third party (relationship tested under sections 267/707 (percentage reduced to greater than 20%)).

Section 1256 contracts –

Deferral under section 1400Z-2(a)(1) only applies to a taxpayer's capital gain net income from section 1256 contracts for a taxable year. In addition, the 180-day period for investing capital gain net income from section 1256 contracts in a QOF begins on the last day of the taxable year.⁹

Eligible taxpayers –

Taxpayers eligible to elect deferral under section 1400Z-2 ("gain deferral election") are those that recognize capital gain for federal income tax purposes. These taxpayers include individuals, C corporations (including RICs and REITs), partnerships, and certain other pass-through entities.¹⁰

Timing of contribution –

The first day of the 180-day period generally is the date on which the gain would be recognized for federal income tax purposes, without regard to the deferral available under section 1400Z-2.¹¹

Observation 1: *For capital gain dividends received by RIC or REIT shareholders, the shareholder's 180-day period for those gains begins on the day on which the dividend is received. However, it may not be known until the end of the RIC or REIT's tax year whether the dividend is eligible for capital gain treatment.*

⁹ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(2)(iii).

¹⁰ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(1).

¹¹ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(4). Note that, for section 1231 gain recognized in a transaction, it may be unclear until the end of the taxable year whether such gain should be reported as capital gain since section 1231 losses recognized later in the year that exceed prior section 1231 gain for that year would cause all gains and losses to be reported as ordinary. IRC section 1231(a).

Observation 2: For undistributed capital gains received by RIC or REIT shareholders, the shareholder's 180-day period for that gain begins on the last day of the RIC or REIT's tax year.¹²

Special partnership rule –

A partnership may make a gain deferral election with respect to its eligible gains. If the election is made, no part of the deferred gain is included in the partners' distributive shares or increases the partners' tax bases.

To the extent that a partnership does not elect to defer all or a part of its eligible gain, that amount of eligible gain is included in the partner's distributive share, and increases the partner's tax basis. In that case, the partner may make its own gain deferral election with respect to its distributive share of such eligible gain, provided that the gain did not arise from a sale or exchange with a person related (using the same greater than 20% test) to the partner.

The partner's 180-day period generally begins on the last day of the partnership's taxable year. A partner who knows (or receives information) regarding both the date of the partnership's gain and the partnership's decision not to elect deferral under section 1400Z-2 may choose to begin its own 180-day period on the same date as the start of the partnership's 180-day period. Similar rules apply to S corporations, trusts, and estates.¹³

Observation 1: Because of the optionality of the partnership or partners making the gain deferral election, proper consideration should be given to which level the election should be made. If one or more of the partners do not want to make the gain deferral election, then it might be more appropriate for the partnership to not make the election and allow each partner to decide on its own. However, if one or more partners are related to the buyer of the property that generated the partnership's eligible gain (presumably determined at the time of the sale or exchange of the property by the partnership), then those partners (e.g., a 20% partner) may not be able to make an election even though the partnership could. As such, the partners could decide to have the partnership make the election.

Observation 2: In the context of a partnership making the gain deferral election, it is still unclear what happens to the partner's basis in its partnership interest if the partnership gets a basis step up under the QOF rules (i.e., after 5, 7, or 10 year holding period). It would appear that the proper tax policy would be to also give the partner its share of the basis step

¹² See *supra*, note 8.

¹³ See Prop. Treas. Reg. §1.1400Z-2(a)-1(c)(1), (c)(1)(i), (c)(2)(i), (c)(2)(ii), and (c)(2)(iii).

up, based on the amount of built-in gain that has been displaced by the step-up.¹⁴

Observation 3: To the extent that the partnership makes a gain deferral election with respect to its eligible gains, then information with respect to such eligible gains would not appear to be included in the partner's K-1. However, if the partnership does not make a gain deferral election with respect to all or a portion of its eligible gains, the partnership will need to provide information on the K-1 to the partners so that the partners could determine how the gain deferral election rules apply to them (e.g., what is the partner's share of the partnership's eligible gain to which the partnership did not make the gain deferral election, when did the sale or exchange take place, and who is the buyer of the property that generated the eligible gain).

Observation 4: If the partnership does not make a gain deferral election with respect to all or a portion of its eligible gains, and the partner would like to use the beginning of the partnership's 180-day period, the partnership may also need to provide the partner with its estimated distributive share of such eligible gain, in addition to the other information in **Observation 3** above, well before the end of the partnership's 180-day period.

Observation 5: It appears that a partnership cannot make a gain deferral election with respect to section 1231 gains, because the treatment of section 1231 gains as long-term capital gains is determined at the partner level.

Current law

As mentioned earlier, an investor must elect to invest its gains into a QOF which is an investment vehicle that is--

- Self-certified by the taxpayer as a QOF;
- Organized as a corporation or a partnership; and
- Invests and holds at least 90-percent of its assets in QOZ property determined by the average of the percentage of QOZ property held in the QOF as measured as of the first 6-month period and on the last day of the QOF's taxable year.

Proposed regulations

Effect of debt on QOF investment eligibility –

Status as an eligible interest is not impaired by the taxpayer's use of the interest as collateral for a loan, whether a purchase-money borrowing or otherwise. Deemed

¹⁴ Cf. Rev. Rul. 96-10, 1996-1 C.B. 138 (reduce basis in partnership interest for disallowed loss); Rev. Rul. 96-11, 1996-1 C.B. 140 (reduce basis in partnership interest for charitable donation in an amount equal to basis of property donated even though deduction is equal to the fair market value of the donated property).

contributions of money under section 752(a) do not result in the creation of an investment in a QOF.¹⁵

Observation 1: *This rule appears to permit QOFs to receive initial equity contributions and to employ debt to fund the remaining portion of the construction and other costs. Additional equity contributions of eligible gains over time could be used to repay all or a portion of that debt, provided the other QOF requirements are met.*

Eligible interests –

An eligible interest in a QOF is an equity interest issued by a QOF, including preferred stock or a partnership interest with special allocations.¹⁶

Observation 1: *This definition of eligible interest does not require that the interests in the QOF be unitized. That is, a partner may receive the full benefits of a gain deferral election with respect to its partnership interest even if its share of the appreciation in partnership assets does not match its proportionate share of partnership capital. For example, a typical tax equity investor in a solar or wind partnership that is a QOF could receive the full benefits of a gain deferral election with respect to its interest in the QOF.*

Observation 2: *It is not entirely clear how this definition would apply in the case of a carried interest. If the carry partner contributes eligible gains for its capital interest (e.g., 1% capital interest), it is arguable that this rule allows the carry partner to obtain full benefits of a gain deferral election with respect to both its capital and carried interest (e.g., 20% carried interest), although the proposed rule does not specifically address this situation.*

Sale of entire interest in a QOF during deferral period –

If a taxpayer acquires an original interest in a QOF in connection with a gain deferral election, if a later sale or exchange of that entire QOF interest triggers an inclusion of the deferred gain, and if the taxpayer makes a qualifying new investment in a QOF, then the taxpayer is eligible to make a gain-deferral election to defer the inclusion of the previously deferred gain. The first day of the 180-day period for the new investment in a QOF is the date that section 1400Z-2(b)(1) provides for inclusion of the previously deferred gain.¹⁷

Observation 1: *For example, if a taxpayer had made a gain deferral election with respect to \$100 of eligible gain, but sells its entire interest for \$120 four years later, the taxpayer would be required to include \$100 of the prior deferred eligible gain in income under the QOZ rules and \$20 of the new gain in income under general tax principles. Pursuant to this rule and*

¹⁵ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(3)(ii) and (iii). See also Prop. Treas. Reg. §1.1400Z-2(e)-1(a)(2).

¹⁶ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(3).

¹⁷ See Prop. Treas. Reg. §1.1400Z-2(a)-1(b)(4)(i) and (4)(ii), Example 4.

Example 4, it appears that the \$100 of the previously deferred gain triggered is eligible gain to which a new gain deferral election may be made. For the remaining \$20 of gain, if the gain meets the requirements to be treated as eligible gain, it appears that the taxpayer may also make a gain deferral election for the additional eligible gain. It also appears that the holding period of the interest in the QOF begins when the taxpayer makes the new QOF investment.

10-year gain elimination rule –

The basis step-up election under section 1400Z-2(c) (the 10-year gain elimination rule) applies only to the portion of the investment in a QOF that was made in connection with a proper gain deferral election. In addition, taxpayers may make the basis step-up election under section 1400Z-2(c) after a QOZ designation expires up until December 31, 2047.¹⁸

Observation 1: *This rule favorably answers the question regarding the interaction of the 10-year gain elimination rule, which could apply well after the QOZ designations expire in 2028. However, there are several unanswered questions relating to the 10-year gain elimination rule. Presumably, these questions will be addressed in the next set of proposed QOZ regulations.*

Timing of 90-percent asset test –

The phrase “first 6-month period of the taxable year of the fund” means the first 6-month period composed entirely of months which are within the taxable year and during which the entity is a QOF. For example, if a calendar-year entity that was created in February chooses April as its first month as a QOF, then the 90-percent asset test testing dates for the QOF are the end of September and the end of December. Moreover, if the calendar-year QOF chooses a month after June as its first month as a QOF, then the only testing date for the taxable year is the last day of the QOF’s taxable year. Regardless of when an entity becomes a QOF, the last day of the taxable year is a testing date.¹⁹

Observation 1: *A QOF needs to properly specify in its self-certification form the first month in which it is to be treated as a QOF to avoid being subject to the 90-percent asset test prematurely. For example, assume an eligible entity is formed on January 1, 2019 with non-qualifying asset X which represents 5% of all assets of the QOF for that taxable calendar year. Asset Y, representing the remaining 95%, is acquired after July 15 of the same taxable calendar year. In such case, if QOF fails to specify the first month in which it is to be treated as a QOF, then it appears that the 6-month 90-percent asset test period begins on January 1, 2019 resulting in a 6-month*

¹⁸ See Prop. Treas. Reg. §1.1400Z-2(c)-1(a) and (b).

¹⁹ See Prop. Treas. Reg. §1.1400Z-2(d)-1(a)(1) and (2).

test period where the QOF holds only asset X. Thus, QOF may not meet the 90-percent asset test requirement.

Observation 2: *It appears that if a calendar-year QOF is formed in December, it will have a one month testing period. As such, if the QOF would fail to meet the requirements during that month, the QOF should consider whether it is more beneficial to wait until the beginning of the following year to be formed.*

Note: There is no prohibition to using a pre-existing entity as a QOF or as a subsidiary entity operating a qualified opportunity business, provided that the pre-existing entity satisfies the requirements under section 1400Z-2(d).²⁰

Determining values for 90-percent asset test –

For purposes of calculating the 90-percent asset test, the QOF must use the asset values that are reported on the QOF's applicable financial statement for the taxable year, as defined in Treas. Reg. §1.475(a)-4(h). If a QOF does not have an applicable financial statement, the QOF must use the cost basis of its assets.²¹

Observation 1: *The use of the words “cost basis” appear to indicate that the original, unadjusted, cost basis of an asset be used for purposes of the 90-percent asset test when applicable financial statements are not available.*

Observation 2: *It is unclear whether certain financial statement assets that are only recorded for GAAP purposes (e.g., certain intangible assets that are not also treated as tax assets) should be included, as those assets could cause a QOF to fail the 90-percent asset test.*

Current law

As mentioned, QOZ property includes QOZ stock, QOZ partnership interests and QOZ business property.

QOZ stock means any stock in a domestic corporation if—

- The stock is acquired by the QOF after December 31, 2017, at its original issue from the corporation solely in exchange for cash;
- At the time such stock was issued, the corporation was a QOZ business (or, in the case of a new corporation, such corporation was being organized for purposes of being a QOZ business); and
- During substantially all of the QOF's holding period for such stock, such corporation qualified as a QOZ business.²²

²⁰ See Prop. Treas. Reg. §1.1400Z-2(d)-1(a)(3).

²¹ See Prop. Treas. Reg. §1.1400Z-2(d)-1(b)(1) and (2).

²² Section 1400Z-2(d)(2)(B)(i).

A QOZ partnership interest means any capital or profits interest in a domestic partnership if—

- Such interest is acquired by the QOF after December 31, 2017, from the partnership solely in exchange for cash;
- At the time the interest was acquired, the partnership was a QOZ business (or, in the case of a new partnership, such partnership was being organized for purposes of being a QOZ business); and,
- During substantially all of the QOF's holding period for such interest, such partnership qualified as a QOZ business.²³

As is the case for both acquiring a partnership or stock interest, the partnership or corporation must be a QOZ business. A QOZ business is a trade or business in which:

- Substantially all of the tangible property owned or leased by the taxpayer is QOZ business property;
- At least 50% of the total gross income of such entity is derived from the active conduct of such trade or business in the QOZ;²⁴
- A substantial portion of the intangible property of such entity is used in the active conduct of such trade or business in the QOZ;²⁵
- Less than 5% of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property, excluding reasonable amounts of working capital;²⁶ and
- It is not a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the

²³ Section 1400Z-2(d)(2)(C).

²⁴ It was unclear from the section 1400Z-2(d)(3)(A)(ii)'s reference to section 1397C(b)(2) whether the 50% of gross income requirement must be "in the qualified opportunity zone." Prop. Treas. Reg. §1.1400Z-2(d)-1(d)(5)(i) indicates that is the correct interpretation of the reference. Real estate businesses must focus carefully on the "active trade or business" requirement in arranging activities within a QOZ. Rev. Rul. 2006-34, 2006-1 C.B. 1172, analyzing the "active trade or business" requirement in the context of section 6166, provides that activities conducted by a taxpayer's employees and agents will be taken into account, but activities conducted by independent contractors that do not also qualify as agents will not be considered, in determining whether real estate operations rise to the level of an active trade or business. The revenue ruling recognizes that third-party property management companies often operate as independent contractors.

²⁵ It was unclear from the section 1400Z-2(d)(3)(A)(ii)'s reference to section 1397C(b)(4) whether the intangible asset usage requirement must be "in the qualified opportunity zone." Prop. Treas. Reg. §1.1400Z-2(d)-1(d)(5)(ii) indicates that is the correct interpretation of the reference.

²⁶The definition of nonqualified financial property is cross referenced to section 1397C(b)(8) and 1397C(e) and includes debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property specified in regulations; except that such term shall not include reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less, or certain accounts or notes receivable acquired in the ordinary course of trade or business .

principal business of which is the sale of alcoholic beverages for consumption off premises.²⁷

Proposed regulations

Working capital safe harbor for QOZ business test –

The working capital safe harbor for QOF investments applies to QOZ businesses that acquire, construct, or rehabilitate tangible business property, which includes both real property and other tangible property used in a business operating in an opportunity zone. The safe harbor allows QOZ businesses to apply the definition of working capital provided in section 1397C(e)(1) to property held by the business for a period of up to 31 months, if three requirements are met: (1) there is a written plan that identifies the working capital assets as property held for the acquisition, construction, or substantial improvement of tangible property in the opportunity zone; (2) there is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets, and under that schedule, the working capital assets are spent within 31 months of the receipt by the business of the financial property; and (3) the working capital assets are actually used in a manner that is substantially consistent with the schedule. Taxpayers would be required to retain any written plan in their records.²⁸

Observation 1: It is not entirely clear what is meant by “consistent with the ordinary start-up of a trade or business.”

Substantially all requirement for ownership or lease of tangible property –

“Substantially all” is defined as “at least 70 percent,” for determining whether substantially all of the tangible property owned or leased by a taxpayer is QOZ business property (as defined under section 1400Z-2(d)(3)(A)(i)).²⁹

Note: The 70-percent threshold is intended to apply only to the term “substantially all” as it is used in section 1400Z-2(d)(3)(A)(i).

Qualifying QOF entities –

A QOF must be an entity classified as a corporation or partnership for federal income tax purposes. In addition, it must be created or organized in one of the 50 States, the District of Columbia, or in a U.S. possession (but only if it is organized for the purpose of investing in QOZ property that relates to a trade or business operated in the possession in which the entity is organized).³⁰

²⁷ Section 1400Z-2(d)(3)(A).

²⁸ See Prop. Treas. Reg. §1.1400Z-2(d)-1(d)(5)(iv).

²⁹ See Prop. Treas. Reg. §1.1400Z-2(d)-1(d)(2) and (3).

³⁰ See Prop. Treas. Reg. §1.1400Z-2(d)-1(a) and (e).

Observation 1: Pursuant to this rule, an LLC or other domestic unincorporated entity may be a qualifying QOF entity.

Current law

QOZ business property means any tangible property used in a trade or business if:

- The property was acquired by purchase after 2017;
- The original use in the QOZ commenced with the taxpayer or the taxpayer substantially improves the property; and
- During substantially all of the taxpayer's holding period, substantially all of the use of such property was in a designated QOZ.³¹

Property is substantially improved by a QOF only if, during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the QOF.³²

Proposed regulations

Substantial improvements of acquired buildings –

A building located on land within a QOZ is treated as substantially improved within the meaning of §1400Z-2(d)(2)(D)(ii) if, during any 30-month period beginning after the date of acquisition of the building, additions to the taxpayer's basis in the building exceed an amount equal to the taxpayer's adjusted basis of the building at the beginning of such 30-month period. Further, the fact that the cost of the land within the QOZ upon which the building is located is not included in the taxpayer's adjusted basis in the building does not mean that the taxpayer is required to separately substantially improve such land for it to qualify as QOZ business property.³³

Observation 1: While the proposed regulations and revenue ruling specifically address the treatment of land where it is located under an existing building, they do not specifically address how to treat unimproved land (or other land where a building is not located) for purposes of the substantial improvement requirement. Treas. Reg. §1.1400Z-2(d)-1(d)(5)(viii), Example, illustrates a QOF that will invest in a partnership that will operate a QOZ business. The partnership will buy land and construct a commercial building on the land. The Example appears designed to illustrate application of the working capital safe harbor and not the substantial improvement rule. The Example does not indicate whether the partnership has a requirement to substantially improve the land nor does it

³¹ Section 1400Z-2(d)(3)(A).

³² Section 1400Z-2(d)(2)(D)(ii).

³³ See Prop. Treas. Reg. §1.1400Z-2(d)-1(c)(8)(i) and (ii). See also Rev. Rul. 2018-29.

indicate whether the substantial improvement requirement has been met. An implication of the Example is that the land does not need to be substantially improved; however, further clarity is needed on this issue.

Form 8996 for self-certification and annual compliance –

It is expected that taxpayers will use Form 8996, *Qualified Opportunity Fund*, both for initial self-certification and for annual reporting of compliance with the 90-percent asset test in section 1400Z-2(d)(1). It is expected that the Form 8996 would be attached to the taxpayer's federal income tax return for the relevant tax years. The IRS has released a draft of this form and instructions contemporaneous with the release of the proposed regulations.³⁴

Form 8949 for gain deferral election –

It is expected that taxpayers will make deferral elections on Form 8949, which will be attached to their federal income tax returns for the taxable year in which the gain would have been recognized if it had not been deferred.

Note: A taxpayer may invest in a QOF in part with gains for which a gain deferral election is made and in part with other funds (for which no gain deferral election is made or for which no such election is available). Section 1400Z-2(e) requires that these two types of QOF investments be treated as separate investments, which receive different treatment for federal income tax purposes (e.g., 10-year basis step-up election is not available for the latter type of investment).

Effective dates –

The regulations generally are proposed to be effective on or after the date of publication in the Federal Register of a Treasury decision adopting these proposed rules as final regulations (final regulations publication date). However—

- An eligible taxpayer may rely on the rules of Prop. Treas. Reg. §1.1400Z-2(a)-1 with respect to eligible gains that would be recognized before the final regulations' date of applicability, but only if the taxpayer applies the rules in their entirety and in a consistent manner.
- A taxpayer may rely on the rules in Prop. Treas. Reg. § 1.1400Z-2(c)-1 with respect to dispositions of investment interests in QOFs in situations where the investment was made in connection with an election under section 1400Z- 2(a) that relates to the deferral of a gain such that the first day of 180-day period for the gain was before the final regulations' date of applicability. This reliance is dependent on the taxpayer's applying the rules of § 1.1400Z-2(c)-1 in their entirety and in a consistent manner.

³⁴ See Prop. Treas. Reg. §1.1400Z-2(d)-1(a)(1)(i).

- A QOF may rely on the rules in Prop. Treas. Reg. §1.1400Z-2(d)-1 with respect to taxable years that begin before the final regulations' date of applicability, but only if the QOF applies the rules in their entirety and in a consistent manner.
- A taxpayer may rely on the rules in Prop. Treas. Reg. § 1.1400Z-2(e)-1 with respect to investments and deemed contributions of money that occur before the final regulations' date of applicability, but only if the taxpayer applies the rules in their entirety and in a consistent manner.

Comments requested –

Comments are requested by December 18, 2018 on the following:

- (1) Possible approach to defining the term “original use” for both real property and other tangible property;
- (2) The transaction that may trigger the inclusion of gain that has been deferred under a section 1400Z-2(a) election;
- (3) Whether an alternative to incentivizing investors to disinvest shortly before any fixed end date for the section 1400Z-2(c) basis step-up election should be made;
- (4) Whether the special rules are sufficient for partnerships and other pass-through entities allowing the entities and taxpayers to invest in a QOF and defer recognition of eligible gain;
- (5) Whether more detailed rules are required to provide additional certainty for investors in pass-through entities that are not partnerships;
- (6) Meaning of the term “substantially all” for purposes of section 1400Z-2;
- (7) Whether any additional rules regarding the “substantial improvement” requirement for tangible property are warranted or would be useful;
- (8) Whether a capital gain from a section 1256 contract should be eligible for deferral under section 1400Z-2 on a per contract basis rather than on an aggregate net basis;
- (9) Whether alternative methods (in addition to first-in, first-out (FIFO) method for a taxpayer disposing of less than all of its fungible interests in a QOF and the pro-rata method under section 1400Z-2(b)(7) to determine the character of the gain recognized) should be used;
- (10) Whether the final regulations should contain exceptions to the general 180-day rule and whether it would be helpful for either the final regulations or other guidance to illustrate the application of the general 180-day rule to additional circumstances;
- (11) How to minimize the burdens and complexity that may be associated with reporting on a per contract basis for section 1256 contracts;

- (12) The “reasonable period” (see section 1400Z-2(e)(4)(B)) for a QOF to reinvest proceeds from the sale of qualifying assets without paying a penalty;
- (13) Adequacy of the “working-capital” safe harbor, ancillary safe harbors that protect a business during the working capital period, and whether there is a statutory basis for any additional relief;
- (14) The administrative rules applicable under section 1400Z-2(f) when a QOF fails to maintain the required 90-percent investment standard; and
- (15) The information-reporting requirements under section 1400Z-2.

The public hearing to discuss these topics is scheduled for January 10, 2019.

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