Opportunity Zones, Late Elections, and New Enforcement and Oversight Actions

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According to legislative history, Congress introduced the QOZ program in hopes that it would help revitalize distressed communities, serve as a catalyst for growth and opportunity, attract inactive capital, stop business closures, foment entrepreneurship, and ensure that local needs are met by allowing state Governors to play a key role in the process.

Introduction

Congress enacted the Qualified Opportunity Zone ("QOZ") legislation in late 2017, serious money has flowed to low-income communities as a result, many projects are underway with more to come, and investors are poised to garner short-term and long-term tax benefits. Moreover, the Internal Revenue Service ("IRS") has steadily issued administrative guidance on various aspects of the QOZ program, with promises of additional direction in the near future. The IRS has also demonstrated notable leniency in issuing private letter rulings ("PLRs"), allowing entities and investors to make critical, late elections. This is encouraging news, no doubt, but is it simply the proverbial calm before the storm? This article describes the purpose of the QOZ legislation, how QOZs were selected, key terminology, tax benefits for investors, filing duties, circumstances under which the IRS has granted PLRs enabling taxpayers to make late elections, and recent enforcement and oversight actions.

Purpose of the Legislation

Congress periodically offers tax incentives designed to encourage private investment in troubled areas.[1] One recent example was the passage of Section 1400Z-1 and Section 1400Z-2, the foundation of the QOZ program. Why did Congress create this law? According to legislative history, Congress introduced

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the QOZ program in hopes that it would help revitalize distressed communities, serve as a catalyst for growth and opportunity, attract inactive capital, stop business closures, foment entrepreneurship, and ensure that local needs are met by allowing state Governors to play a key role in the process.[2] The IRS's explanation for the legislation was more clinical. It stated that the idea was "to provide specified federal income tax benefits to [investors] to encourage the making of longer-term investments . . . of new capital in one or more [QOZs] and to increase the economic growth of such [QOZs]."[3]

Selecting Locations for Investment

A QOZ is a "low-income community" that was properly designated.[4] Designation was a two-step process. The Chief Executive Officer of each state, which was ordinarily the Governor, first reviewed eligible properties and *nominated* particular tracts for QOZ status. After receiving the nominations, the Treasury Secretary, with assistance from the Community Development Financial Institutions Fund, certified some of them.[5] The deadline for designating QOZs closed in mid-2018, such that there will be no additional QOZs, absent a legislative change in the future.[6] There are approximately 8,750 QOZs.[7]

In identifying potential tracts for QOZ status, Governors were instructed to give appropriate consideration to areas that (i) are already the focus of state, local and/or private economic-development initiatives, (ii) have experienced significant layoffs due to business closures or relocations, and (iii) have prior success with geographically-targeted programs, such as Promise Zones, New Market Tax Credits, Empowerment Zones, and Renewal Communities.[8]

Limits existed on the number of QOZs, of course. Generally, the amount of QOZs could not exceed 25 percent of the total low-income communities in a particular state.[9] Certain tracts of land that did *not* qualify as low-income communities could still become QOZs. For this to occur, the tract in question had to be contiguous to a QOZ, and the median family income in such tract could not exceed 125 percent of that in the neighboring QOZ.[10] Not more than five percent of the tracts in a state could achieve QOZ status thanks to the contiguous-property method.[11]

Key Terminology

As one would expect with a multi-billion dollar government incentive program, the terms and rules are extremely complicated; several hundreds of pages of regulations prove that. For purposes of this article, it is enough to review the main characters in a simplified scenario. They consist of investors, Qualified Opportunity Fund ("QOF"), and Qualified Property.

- Eligible taxpayers, often referred to as investors, engage in a transaction triggering capital gains, which they then invest in a QOF within 180 days of the transaction. Investors can be certain individuals, business entities, tax-exempt organizations, trusts or estates, but this article refers to all investors as individuals for the sake of simplicity.[12]
- A QOF is a partnership or corporation established for purposes of investing in Qualified Property, which holds at least 90 percent of its assets in Qualified Property.[13]
- Qualified Property means tangible property, acquired by cash purchase after December 31, 2017, whose original use begins with the QOF or which is substantially improved by the QOF, and substantially all of whose use takes place within the QOZ.[14] A QOF can hold Qualified Property in one of two ways, directly or indirectly. Direct ownership needs no further discussion. Indirect ownership, however, requires an explanation. A QOF can own either Qualified Stock in a corporation or a Qualified Interest in a partnership, and such entity, in turn, holds Qualified Property.[15]

Tax Benefits for Investors

Investors in QOFs hope to take advantage of the three tax benefits.

First Benefit – Tax Deferral on Rollover Gain

A taxpayer generally can elect to defer federal income taxes on the capital gains triggered by engaging in a sale or exchange of property with an unrelated person, as long as the taxpayer invests such gains in a QOF within 180 days.[16] In other words, a taxpayer can postpone paying federal income taxes on capital gains if he properly reinvests them in a QOF ("Rollover Gains").[17] The tax deferral can theoretically last up to nine years, from 2018 (i.e., the first year tax deferral was available) through 2026 (i.e., the termination date set forth in the regulations). The tax deferral might end before 2026, though, if the taxpayer disposes of his QOF investment earlier, or if another "inclusion event" occurs.[18]

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1 U.S. Senate, Committee on the Budget. Reconciliation Recommendations Pursuant to H. Con. Res. 71. 115th Congress, 1st Session, Report 115-20 (Dec. 2017), pg. 318; U.S. House of Representatives, Conference Report. Tax Cuts and Jobs Act. 115th Congress, 1st Session, Report 115-466 (Dec. 15, 2017), pg. 537.

2 U.S. Senate, Committee on the Budget. Reconciliation Recommendations Pursuant to H. Con. Res. 71. 115th Congress, 1st Session, Report 115-20 (Dec. 2017), pg. 318.

3 Treas. Reg. § 1.1400Z-2(f)-1(c)(1).

4 Section 1400Z-1(a). For these purposes, the definition of "low-income community" is the same as that used in Section 45D(e) in connection with the New Market Tax Credit. *See* Section 1400Z(c)(1).

5 Section 1400Z-1(b)(1); Section 1400Z-1(c)(2). For more information on the Community Development Financial Institutions Fund, *see* Congressional Research Service, Community Development Financial Institutions Fund: Programs and Policy Issues. Report R42770 (Jan. 2018).

6 Revenue Procedure 2018-16, Section 2.06.

7 U.S. Joint Committee on Taxation. Qualified Opportunity Zones: An Overview (June 2019), pg. 15.

8 U.S. Senate, Committee on the Budget. Reconciliation Recommendations Pursuant to H. Con. Res. 71. 115th Congress, 1st Session, Report 115-20 (Dec. 2017), pg. 319; U.S. House of Representatives, Conference Report. Tax Cuts and Jobs Act. 115th Congress, 1st Session, Report 115-466 (Dec. 15, 2017), pg. 538.

9 Section 1400Z-1(d)(1). If a state had fewer than 100 low-income communities, then up to 25 tracts could be QOZs. *See* Section 1400Z-1(d)(1).

10 Section 1400Z-1(e)(1).

The taxpayer's basis in the Rollover Gains is $0 when he reinvests them in a QOF, but the basis increases somewhat the longer the taxpayer keeps his QOF investment. The tax-reduction-via-basis-adjustments are described further below.

A taxpayer can choose to invest *all* the proceeds from a sale or exchange of property in a QOF, meaning both the return of basis and the capital gain. This produces what is called a "Mixed Fund."[19] However, tax deferral *only* applies to the Rollover Gain (i.e., capital gain), as shown by the following examples:

> [I]f a taxpayer sells stock at a gain and invests the entire sales proceeds (capital and return of basis) in a [QOF], an election can be made only with respect to the capital gain amount. No election can be made with respect to the amounts attributable to a return of basis, and no special tax benefits apply to such amounts.[20]

Second Benefit – Reduced Taxes on Rollover Gain

If a taxpayer maintains his investment in a QOF for more than five years before disposing of it, then the Rollover Gain will be subject to reduced taxes.[21] This benefit is not the result of *lowering* the tax rate, but rather it stems from *increasing* the taxpayer's basis in the Rollover Gain from $0. Put another way, the tax rate remains the same, but the amount of gain subject to such rate drops.[22]

Specifically, if a taxpayer holds the QOF investment for at least five years before disposing of it, then his basis increases by 10 percent of the Rollover Gain.[23] The pot gets sweeter where a taxpayer holds his QOF investment for at least seven years; the basis rises to 15 percent of the Rollover Gain.[24]

The character of the Rollover Gain survives the QOF investment.[25] This means that when tax-deferral ends and the IRS obligates taxpayers to pay taxes on the Rollover Gain, the question of whether it will face short-term or long-term capital gain rates is dictated by the character of the Rollover Gain at the time it was originally invested in the QOF years earlier. In other words, holding the Rollover Gain in a QOF for several years does *not* serve to convert it from short-term to long-term.[26]

Third Benefit – Tax Exclusion on Fund Appreciation

In cases where a taxpayer stays the course for at least 10 years, he avoids federal income taxes altogether on the appreciation of the Rollover Gain as a result of its longstanding investment in a QOF ("Fund Appreciation").[27] As readers will recall, the taxpayer will have already paid federal income taxes on the Rollover Gain by or before 2026, although in a reduced amount thanks to the basis increase of 10 percent or 15 percent. The issue here focuses on exclusion of Fund Appreciation (i.e., the passive income generated on the Rollover Gain invested in a QOF) from federal income taxes for a taxpayer who holds his QOF investment for at least 10 years.

This tax exclusion, which taxpayers must elect, occurs by way of basis adjustment, as opposed to tax-rate manipulation. If the taxpayer disposes of his QOF investment after the 10-year period, his basis in the QOF investment will be equal to the fair market value of the QOF investment on the date of disposition.[28] The IRS assumes that the fair market value and sales price will be one and the same.[29] The effect of increasing the basis to match the sales price is an exclusion of Fund Appreciation from federal income taxes. A taxpayer must hold the QOF investment for at least 10 years to benefit from income exclusion, but he can maintain it much longer if he so desires. In particular, a taxpayer can keep the QOF investment and make the income-exclusion election up until December 31, 2047.[30]

Summary of the Three Tax Benefits

In summary, Section 1400Z-2 essentially offers three tax benefits for an investor: (i) Deferral for up to nine years on payment of federal income taxes on Rollover Gain, which allows the investor to harness the time value of money; (ii) Reduction of income taxes on Rollover Gain when a taxpayer holds the QOF investment for at least five years, achieved through basis increases; and (iii) Complete exclusion of Fund Appreciation from federal income taxes when a taxpayer holds the QOF investment 10 years or more, accomplished, again, by way of basis increases.[31] Below is an illustration of how these tax benefits function together:

> On June 30, 2019, Taxpayer has a basis in XYZ stock of $40 and sells such stock for $140, realizing a capital gain of $100. Taxpayer reinvests the $100 gain (but not the $40 return of capital) in a QOF within the 180-day period. Taxpayer does not have to pay tax on the capital gain in 2019. Taxpayer's initial basis in the QOF investment is $0. On June 30, 2024, Taxpayer has held the QOF investment at least five years, so his basis increases to $10. On June 30, 2026, Taxpayer has held the QOF investment at least seven years, so his basis increases an additional $5 to $15. On December 31, 2026, Taxpayer must recognize $85 of gain (i.e., $100 in Rollover Gain less $15 in basis), even though he has not sold the QOF investment. On July 1, 2029, Taxpayer has held the QOF investment for at least 10 years, so he sells it for $219 and pays no additional tax on the Fund Appreciation.[32]

Tax and Information Returns

Participation in a QOF investment triggers several reporting obligations with the IRS, the most noteworthy of which are examined below.

Investors must file their annual tax return, which, in the case of individuals, is Form 1040 (U.S. Individual Income Tax Return). They must enclose various information returns with their Forms 1040. For example, investors file a Form

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11 Section 1400Z-1(e)(2).

12 Treas. Reg. § 1.1400Z2(a)-1(b)(13).

13 Section 1400Z-2(d)(1); Treas. Reg. § 1.1400Z2(a)-1(b)(18); Treas. Reg. § 1.1400Z2(d)-1(a).

14 Section 1400Z-2(d)(2)(A); Section 1400Z-2(d)(2)(D)(i); Treas. Reg. § 1.1400Z2(a)-1(b)(32); Treas. Reg. § 1.1400Z2(d)-2(a). The required use or improvements can be by the QOF itself or a "qualified opportunity zone business."

15 Section 1400Z-2(d)(2)(B); Section 1400Z-2(d)(2)(C); Treas. Reg. § 1.1400Z2(a)-1(b)(31); Treas. Reg. § 1.1400Z2(a)-1(b)(33); Treas. Reg. § 1.1400Z2(d)-1(c).

16 Section 1400Z-2(a)(1)(A); Treas. Reg. § 1.1400Z2(a)-1(a); Treas. Reg. § 1.1400Z2(a)-1(b)(10); Treas. Reg. § 1.1400Z2(a)-1(c)(5); Treas. Reg. § 1.1400Z2(a)-1(d). Initial confusion existed as to whether tax deferral was open to both ordi-

8949 (Sales and Other Dispositions of Capital Assets) to report the capital gain they are deferring thanks to their QOF investment (i.e., Rollover Gain), as well as any capital gains that they later must recognize.[33] Individual investors also must file Form 8997 (Initial and Annual Statement of Qualified Opportunity Fund Investments) to notify the IRS about the Rollover Gain, the value of the QOF investment at the beginning and end of each year, any capital gains triggered by the end of tax-deferral on Rollover Gain or by disposition of the QOF investment, and more.[34]

QOFs have duties, too. They must file their annual tax return, namely, Form 1065 (U.S. Return of Partnership Income) or one of the many varieties of Form 1120 (U.S. Corporation Income Tax Return). Moreover, QOFs must enclose Form 8996 (Qualified Opportunity Fund) to self-certify to the IRS that they meet all standards to be QOFs, provide details about their direct or indirect investment in Qualified Property, and calculate the penalty if they fail to maintain the 90-percent investment standard.[35] QOFs also need to submit Forms 1099-B (Proceeds from Broker or Barter Exchange Transactions) to report when investors dispose of QOF investments.

Rectifying Missed Elections

As mentioned earlier in this article, investing through a QOF necessarily involves making various elections throughout the cycle. Investors, at the outset, must file a Form 8949 and Form 8997 to elect to defer the Rollover Gain. For their part, partnerships and corporations electing to be QOFs must file Form 1065 or Form 1120-S, enclosing Form 8996. This does not always happen, of course, so many investors and aspiring QOFs must seek permission from the IRS to make late elections.

Background on Allowing Late Elections

Specific regulations permit taxpayers to obtain extensions to make elections and obtain the corresponding tax relief.[36] In formulating the standards for granting an extension, the IRS identified two critical policies. The first is promoting efficient tax administration by creating limited periods for taxpayers to choose among alternative tax treatments. The second policy, which is more pertinent to this article, is "permitting taxpayers that are in reasonable compliance with the tax laws to minimize their tax liability by collecting from them only the amount of tax they would have paid if they had been fully informed and well advised."[37]

The regulations contemplate two main types of elections. There are "regulatory elections," meaning those whose deadline is set by a published regulation, Revenue Ruling, Revenue Procedure, Notice, or Announcement.[38] There are also "statutory elections," which are those whose due date is fixed in a tax provision found in the Internal Revenue Code.[39] If the deadline for a "regulatory election" has passed, taxpayers may request an extension to file a late election.[40]

Standards for Relief

The IRS has discretion to grant reasonable extensions.[41] Extension requests "will be granted" when the taxpayer supplies evidence (including the requisite affidavits) to establish to the IRS's satisfaction that the taxpayer acted reasonably and in good faith, and that granting the extension will not prejudice the IRS's interests.[42] These two factors are examined below.

First Factor – Reasonableness and Good Faith

The IRS considers a taxpayer to have acted reasonably and in good faith if one or more of the following is true: The taxpayer (i) requests relief before the IRS discovers the missing regulatory election, (ii) failed to make the election because of intervening events beyond the taxpayer's control, (iii) was unaware of the need to make an election after exercising reasonable diligence, taking into account the taxpayer's experience, as well as the complexity of the return or issue, (iv) reasonably relied on written advice from the IRS, or (v) reasonably relied on a qualified, informed, tax professional, and such professional failed to make the election or advise the taxpayer to do so.[43]

Notwithstanding the general rules above, the IRS will deny the existence of reasonableness and good faith if the taxpayer seeks to alter a return-position for which the IRS has imposed or could impose accuracy-related penalties, the taxpayer knew all material aspects of the election (including the related tax consequences) but chose not to file it, or the taxpayer uses "hindsight" in requesting relief.[44]

Second Factor – No Prejudice to the IRS

The IRS applies two standards when evaluating the second element; that is, whether authorizing a taxpayer to make a late election will be beneficial to the taxpayer, but detrimental to the IRS.[45] First, the interests of the IRS are prejudiced if granting the extension would result in a taxpayer having a lower tax liability in the aggregate, for all taxable years affected by the election, than the taxpayer otherwise would have had if he had made a timely election in the first place, taking into account the time value

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nary income and capital gains, or just the latter. This uncertainty resulted from the fact that the title of Section 1400Z-2 and legislative history expressly state "capital gains," whereas the general rule in Section 1400Z-2(a)(1) broadly references "gain." The position of the IRS, announced in the first set of proposed regulations, is that "based on the legislative history as well as the text and structure of the statute, Section 1440Z-2 is best interpreted as making [tax] deferral available only for capital gains." *See* REG-115420-18, Preamble, Oct. 19, 2018, pg. 6.

[17] The regulations refer to these as "eligible gains," not Roller Gains. *See* Treas. Reg. § 1.1400Z2(a)-1(b)(11).

[18] Treas. Reg. § 1.1400Z2(a)-1(b)(14); Treas. Reg. § 1.1400Z2(b)-1(b).

[19] Treas. Reg. § 1.1400Z2(a)-1(b)(15); Treas. Reg. § 1.1400Z2(a)-1(f).

[20] U.S. Joint Committee on Taxation. General Explanation of Public Law 115-97. JCS-1-18 (Dec. 2018), pgs. 319-320.

[21] Section1400Z-2(b)(1).

[22] Section1400Z-2(b)(2).

[23] Section1400Z-2(b)(2)(B)(iii); Treas. Reg. § 1.1400Z2(b)-1(g).

[24] Section1400Z-2(b)(2)(B)(iv); Treas. Reg. § 1.1400Z2(b)-1(g).

[25] Treas. Reg. § 1.1400Z2(a)-1(c)(1); Instructions for Form 8949 (2021), pg. 11; *See also* IRS Publication 544 – Sales and Other Dispositions of Assets (2021), pg. 19.

[26] Treas. Reg. § 1.1400Z2(a)-1(c)(1); Instructions for Form 8949 (2021), pg. 11; *See also* IRS Publication 544 – Sales and Other Dispositions of Assets (2021), pg. 19.

of money.[46] Second, the IRS's interests are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any subsequent taxable years that would have been affected by a timely election, are closed before the IRS grants the taxpayer permission to make a late election.[47]

Late Elections Allowed Thus Far

The QOZ program is relatively new, but many investors and entities have already incurred problems with making various elections. This segment of the article examines the private letter rulings ("PLRs") issued thus far by the IRS, which have allowed taxpayers to achieve their goals despite procedural shortcomings. Readers will note that the IRS has been uncharacteristically flexible about the justifications that it finds reasonable in the QOZ context.

PLRs for Investors – Late Forms 8949 and Forms 8997

The IRS has released two PLRs to investors. In both instances, the IRS determined that the non-compliance was reasonable and in good faith because it resulted from reliance on a qualified, informed, longstanding, tax professional. The IRS also observed that the investors pro-actively sought relief before the IRS discovered the violations, they were not benefiting from hindsight, and they were not prejudicing the IRS's interests. The IRS ultimately granted the investors a reasonable period to file the necessary Forms 1040, Forms 8948, and Forms 8997.

PLR 202021009

The taxpayer sold his stock in a Subchapter S corporation. The buyer and taxpayer made a joint irrevocable election under Section 338(h)(10) to recharacterize the stock sale as an asset sale for federal tax purposes. The taxpayer intended to invest part of the proceeds from the sale into one or more QOFs, thereby accessing federal income tax deferral on the Rollover Gain. To this end, he hired an attorney, who supposedly had experience in various federal tax matters, including QOZs. The attorney advised the taxpayer on requirements, helped him form entities, and drafted necessary documents. The attorney informed the taxpayer that the 180-day reinvestment period began the date of the stock sale. Later, the attorney told the taxpayer that the IRS had created, in its second set of proposed regulations, a special, longer reinvestment period for capital gains derived from the sale of so-called Section 1231 property. In providing advice to the taxpayer, the attorney "assumed" that most of the gains from the taxpayer's sale of stock were Section 1231 gains because the parties made a Section 338(h)(10) election. After the original 180-day reinvestment period had expired, the taxpayer received from the buyer an allocation schedule. It showed, contrary to the attorney's earlier assumptions, that nearly all the purchase price had been allocated to goodwill and other intangibles, which were *not* Section 1231 gains, such that the special reinvestment period would not apply.

PLR 202211005

The taxpayer held an ownership interest in a partnership, which sold property at a gain. A portion of such gain was allocated to the taxpayer. The taxpayer reinvested this Rollover Gain in a QOF within the 180-day reinvestment period. The taxpayer fully informed his longstanding tax advisor of these actions. The tax advisor began researching filing duties, but he mistakenly focused on those pertaining to QOFs, instead of investors. As a result, when the tax advisor prepared the taxpayer's Form 1040 for the year of reinvestment, Year 1, he failed to enclose Form 8949. Then, unaware of his earlier oversight, the tax advisor neglected to include Form 8997 with the Form 1040 for Year 2. To make matters worse, after receiving a notice from the state tax authorities and rummaging through files, the tax advisor realized that he never filed Forms 1040, Forms 8949, Forms 8997, or anything else for the taxpayer for Year 1 or Year 2. The tax advisor blamed this lack of filing on unspecified health problems he was experiencing at the time.

PLRs for QOFs – Late Forms 8996

Botched elections appear more prevalent with aspiring QOFs than with investors. The IRS has issued more than two dozen PLRs allowing partnerships and corporations to rectify matters primarily caused by unfiled or late tax returns and Forms 8996. In all the PLRs described below, the IRS granted the entities extensions to file Forms 8996 in order to elect QOF treatment and to self-certify eligibility for QOF status. The IRS determined that each case involved a "regulatory election," the entity acted reasonably and in good faith, and permitting a delinquent election would not harm the IRS. Depending on the facts, the IRS either conceded the entity a reasonable period to file Form 1065 or Form 1120-S enclosing Form 8996, or deemed timely the late returns already filed by the entity before submitting the PLR request.

PLR 202019017

The taxpayer was a partnership formed for purposes of being a QOF. Representatives of the taxpayer met with an advisor regarding return-filing obligations for its first year of operation. The advisor was tasked with filing a Form 7004 (Application for Automatic Extension of Time to File Certain Business Income Tax, Information, or Other Returns) to extend the deadline, preparing and filing Form 1065 with all items necessary to self-certify as a QOF, and treating the taxpayer as a QOF from the date it was formed. Both the taxpayer and advisor were aware of the need to enclose Form 8996 with a timely Form 1065. Because

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[27] Section 1400Z-2(c); Treas. Reg. § 1.1400Z2(c)-1. The regulations refer to this as "post-acquisition gain," not Fund Appreciation.

[28] Section 1400Z-2(a)(1)(C); Section 1400Z-2(c); Treas. Reg. § 1.1400Z2(c)-1.

[29] TD 9889, Preamble, pg. 112 (explaining that general federal income tax principles dictate that "fair market value of property will generally be equal to the actual sales price of such property when a buyer and seller are unrelated . . . therefore, in a disposition of assets of a QOF to an unrelated party where the taxpayer makes a valid [tax exclusion] election under Section 14000Z-2(c), the relevant fair market value of the assets generally would be the sale price.")

[30] TD 9889, Preamble, pg. 122.

[31] U.S. Senate, Committee on the Budget. Reconciliation Recommendations Pursuant to H. Con. Res. 71. 115th Congress, 1st Session, Report 115-20 (Dec. 2017), pgs. 319-320; U.S. House of Rep-

of an "administrative error," the advisor failed to file Form 7004, which resulted in the taxpayer, through the advisor, filing a late Form 1065 and Form 8996.

PLR 202103013

The taxpayer was a partnership formed for purposes of being a QOF. The principal owners of the taxpayer started the business within a QOZ, obtained the required permits and licenses, executed a lease, and more. The principal owners of the taxpayer were also the principal owners of certain affiliated companies. The tax advisor had prepared Forms 1040 for the principal owners for several years. The tax advisor was aware of the taxpayer's desire to be a QOF and the need to enclose Forms 8996 with Forms 1065 for the taxpayer. For some unexplained reason, however, the tax advisor did not enclose Forms 8996.

PLR 202116011

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired an advisor to prepare and file Form 1065 with all items necessary to self-certify as a QOF, and treat the taxpayer as a QOF from the date of inception. The advisor "was retained" so that taxpayer could comply with Form 8996 duties and "was expected" to file timely Forms 8996. For a reason not revealed in the PLR request, the advisor did not file the initial Form 1065 and Form 8996 by the deadline.

PLR 20212004

The taxpayer, a start-up company, was a partnership formed for purposes of being a QOF. It bought property within a QOZ and focused on hiring its workforce and conducting other essential operations. The taxpayer was unaware of the obligation to enclose a Form 8996 with its Form 1065. It was also ignorant of the need to include particular language in its Operating Agreement about its plan to be a QOF. The Chief Financial Officer of the taxpayer, who doubled as its tax advisor, did not participate in discussions about QOF status or related communications with investors. Consequently, the Chief Financial Officer did not enclose a Form 8996 with Form 1065.

PLR 202120010

The taxpayer was a partnership formed for purposes of being a QOF. The director and controller of the taxpayer believed that it was not required to file Form 1065 for Year 1 because it had no activity during that initial period. The director and controller did not understand that, because taxpayer was established and funded in Year 1, it had to file Form 1065 enclosing Form 8996 to elect QOF status and self-certify eligibility. Later, when taxpayer sought assistance from an outside accounting firm, it learned of its missed filing obligations.

PLR 202120014

The taxpayer was a Subchapter S corporation formed for purposes of being a QOF. A financial advisor advised and assisted with the creation of the taxpayer as a QOF. The financial advisor contacted an accountant and informed him of taxpayer's intent to be a QOF, but did not specify that taxpayer was a Subchapter S corporation, as opposed to a Subchapter C corporation. The accountant mistakenly believed that taxpayer was a Subchapter C corporation. Accordingly, he thought that the deadline for filing Form 1120 enclosing Form 8996 was April 15, instead of March 15, the deadline for filing Form 1120-S. The accountant attempted to e-file Form 7004 for the taxpayer, checking the box for Form 1120. The IRS rejected it, but the accountant did not understand why. The accountant later completed a draft Form 1120 with Form 8996 and subjected it to internal review. The entity-classification error was then discovered. Changing gears, the accountant prepared and filed Form 1120-S and Form 8996 late.

PLR 202123005

The taxpayer was a partnership formed for purposes of being a QOF. According to its Operating Agreement, the taxpayer's manager was in charge of ensuring that all required tax and information returns were handled properly. The manager hired accountants to prepare and file Form 1065 and Form 8996, but he erroneously believed that the deadline had been extended because of the Coronavirus. As a result of this misunderstanding, the manager did not provide the accountants with the materials needed until after the deadline. The accountants completed and filed Form 1065 and Form 8996 as soon as possible, but they were still late.

PLR 202140012

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer's manager hired an attorney and a tax advisor, both of whom had significant experience with the real estate industry and related tax matters. The manager never discussed forming a QOF with the attorney, was unaware of the need to file Form 8996, and erroneously believed that the taxpayer had no duty to file Form 1065 and Form 8996 because it had no activity. Upon discovering the problems, manager instructed the tax advisor to file the late returns.

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resentatives, Conference Report. Tax Cuts and Jobs Act. 115th Congress, 1st Session, Report 115-466 (Dec. 15, 2017), pgs. 538-539; U.S. Joint Committee on Taxation. General Explanation of Public Law 115-97. JCS-1-18 (Dec. 2018), pg. 317; Congressional Research Service. Tax Incentives for Opportunity Zones. Report R45152 (April 26, 2022), pgs. 3-6.

[32] U.S. Joint Committee on Taxation. Qualified Opportunity Zones: An Overview (June 2019), pg. 11 (modified by author to enhance readability); *See also* U.S. Joint Committee on Taxation. General Explanation of Public Law 115-97. JCS-1-18 (Dec. 2018), pgs. 320-321.

[33] Instructions for Form 8949 (2021), pg. 11; *See also* IRS Publication 544 – Sales and Other Dispositions of Assets (2021), pg. 19.

[34] Form 8997 (Initial and Annual Statement of Qualified Opportunity Fund Investments).

[35] Form 8996 (Qualified Opportunity Fund); Instructions for Form 8996 (Rev. Dec. 2021).

[36] Treas. Reg. § 301.9100-1 through Treas. Reg. § 301.9100-3.

[37] T.D. 8742, 62 Fed. Reg. 68168.

[38] Treas. Reg. § 301.9100-1(b).

[39] *Id.*

[40] Treas. Reg. § 301.9100-3; *See, e.g.,* Field Service Advisory 200202022 (Sept. 24, 2001).

[41] Treas. Reg. § 301.9100-1(c).

[42] Treas. Reg. § 301.9100-1(c); Treas. Reg. § 301.9100-3(a).

[43] Treas. Reg. § 301.9100-3(b)(1).

[44] Treas. Reg. § 301.9100-3(b)(3). The improper use of "hindsight" occurs when facts have changed since the original due date for the election that cause the election to be more advantageous to the taxpayer later.

PLR 202141004

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired a tax advisor, who was aware that the partnership had purchased property in a QOZ and intended to be a QOF. The taxpayer had no activity in Year 1, and the tax advisor was unaware that the taxpayer needed to file Form 1065 nonetheless solely for purposes of enclosing Form 8996. The taxpayer was displeased with the level of service from the tax advisor, so it engaged an accounting firm in Year 2. After reviewing the matter, the accounting firm notified the taxpayer of the non-compliance in Year 1.

PLR 202144010

The taxpayer was a partnership formed for purposes of being a QOF. The members of the taxpayer "were not well versed in tax law or the procedures for forming a QOF." Therefore, they hired an advisor to serve as both tax advisor and return preparer. The advisor was in charge of filing Form 7004 to extend the deadline for Form 1065 and Form 8996, but failed to do so for undisclosed reasons. The advisor later acknowledged the problem to the taxpayer.

PLR 202149003

The taxpayer was a partnership formed for purposes of being a QOF. Two members owned all interests in the partnership. The members hired an attorney to form the partnership and draft its Operating Agreement, and they retained an accounting firm to provide tax compliance and advisory services. They told the accounting firm about the investment, but did not explicitly state that it was a partnership or a QOF. The two members had each utilized single-member limited liability companies as investment vehicles in the past, and such entities were treated as disregarded entities for federal tax purposes. Therefore, the two members were initially unaware that the partnership was, indeed, a partnership or that it needed to file Form 1065. After the deadline for Year 1 had passed, the accounting firm assigned a new accountant to the members. He discovered the problem and informed the members accordingly. They, in turn, hired an attorney to help resolve matters.

PLR 202151003

The taxpayer was a limited partnership formed for purposes of being a QOF. It was managed by its general partner, who initially hired a law firm and tax advisor. The taxpayer decided not to solicit funds from investors in Year 1, terminated the law firm and tax advisor, and paused its operations because of the Coronavirus. The general partner knew about the duty to file Form 1065 enclosing Form 8996 for Year 1, but mistakenly believed that such returns were due on the same day as Forms 1040 for investors. The taxpayer, therefore, missed the deadline. Upon discovering the issue, the taxpayer filed a late Form 1065 enclosing a late Form 8996.

PLR 202152013

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired an accountant, who had prepared tax returns for members of the taxpayer and various related entities for 16 years. The accountant knew that taxpayer intended to be a QOF, but for some unknown reason, he filed a timely Form 1065 omitting Form 8996. The taxpayer subsequently hired another accounting firm, which identified the non-compliance.

PLR 202152017

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired advisor 1 to assist in forming the partnership and structuring it to meet the QOF requirements. The taxpayer engaged advisor 2 to prepare Form 7004 for Year 1, which he did. Then, the taxpayer retained advisor 3, who portrayed himself as an expert in QOZs, to prepare Form 1065 and Form 8996. The taxpayer and advisor 1 met with advisor 3 to discuss the QOF structure in connection with preparation of Form 1065 and Form 8996. The meeting ended with advisor 3 indicating that he would contact the taxpayer if needed any additional information; he never did. The taxpayer tried to contact advisor 3 multiple times during the following months to check the status of the returns. At some point, advisor 3 indicated that he would have the returns ready before the extended deadline. His feelings changed at some point, though, and advisor 3 told the taxpayer "the returns should not be filed" because problems existed with the structure rendering the QOF non-compliant. Advisor 3 recommended that the taxpayer seek further advice from any attorney. Consistent with that recommendation, the taxpayer consulted advisor 4, who concluded that the QOF structure was fine and the concerns by Advisor 3 were unwarranted. The taxpayer then filed a late Form 1065, enclosing a late Form 8996.

PLR 202202009 and PLR 202203007

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired an accounting firm, which had prepared income tax returns for members and affiliates of the taxpayer for the past three years. The taxpayer understood that the accounting firm was "competent and sophisticated in handling federal income tax matters," but it nonetheless failed to file Form 1065 and Form 8996 by the deadline. The accounting firm later discovered its oversight and notified the taxpayer.

PLR 202204002

The taxpayer was a limited partnership formed for purposes of being a QOF. The taxpayer purchased real estate within a QOZ. An attorney and accountant, both hired by the taxpayer, discussed the need for taxpayer to file a timely Form 1065 enclosing Form 8996, and the accountant confirmed that he would

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[45] Treas. Reg. § 301.9100-3(c).

[46] Treas. Reg. § 301.9100-3(c)(1)(i).

[47] Treas. Reg. § 301.9100-3(c)(1)(ii).

[48] Treasury Inspector General for Tax Administration. Additional Actions Are Needed to Address Qualified Opportunity Zone Fund and Investor Noncompliance. Report 2022-40-018 (Feb. 2022), pgs. 5-6; *See also* Jonathan Curry, "IRS Lacks Plan for Keeping Opportunity Zone Investors in Line," 2022 Tax Notes Today Federal 29-2 (Feb. 11, 2022).

[49] Treasury Inspector General for Tax Administration. Additional Actions Are Needed to Address Qualified Opportunity Zone Fund and Investor Noncompliance. Report 2022-40-018 (Feb. 2022), pg. 8; *See also* Jonathan Curry, "IRS Lacks Plan for Keeping Opportunity Zone Investors in Line," 2022 Tax Notes Today Federal 29-2 (Feb. 11, 2022).

handle it. The accountant prepared Form 1065, but he failed to review the related notes and include Form 8996. The accountant blamed this error on the ongoing Coronavirus pandemic. The taxpayer discovered the problem the following year, when it began gathering data for the accountant to prepare the annual returns.

PLR 202205020 and PLR 202205021

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired an accountant, who had more than 40 years of experience in public and private accounting. The taxpayer was part of a "real estate collective," and accountant had prepared returns for numerous affiliated companies for years. Because of some unspecified "miscommunication," the accountant initially filed Form 1065 for the taxpayer showing no capital contributions and no activity, and not enclosing Form 8996. A few weeks later, the "miscommunication" was discovered, and the accountant filed an amended Form 1065, but he still failed to enclose a Form 8996. Finally, the taxpayer hired a national accounting firm, which readily identified the earlier problems.

PLR 202206015

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired an advisor to prepare Form 1065 and Form 8996. The advisor filed Form 7004 to obtain some breathing room, and later filed Form 1065 before the extended deadline. In doing so, however, he failed to enclose Form 8996. To exacerbate matters, the advisor then told the taxpayer that he had timely e-filed Form 1065, the IRS had accepted it, and no further action on the part of the taxpayer was necessary. The next year, in gathering data to prepare returns, the taxpayer happened upon the earlier noncompliance.

PLR 202206016

The taxpayer was a partnership formed for purposes of being a QOF. Representatives of the taxpayer communicated with advisor 1 (the personal tax advisor for another company owned by a member of the taxpayer) and with advisor 2 (an outside accountant) regarding the QOF investment. The representatives expected advisor 1 and advisor 2 to work together on preparing and filing Form 1065 and Form 8996. Confusion ensued. Specifically, advisor 1 believed that the accounting firm retained by the business in which the taxpayer was investing would be in charge of all returns. Advisor 2, meanwhile, thought that advisor 1 would prepare everything for the taxpayer. The result was that nobody filed a timely Form 1065 and Form 8996 for the taxpayer. It later learned of the too-many-cooks-in-the-kitchen problem.

PLR 202209009

The taxpayer was a partnership formed for purposes of being a QOF. The only two members were a married couple. They hired a seasoned accountant, notified him of QOF status, and expected him to prepare a timely Form 1065 and Form 8996. The accountant mistakenly believed that the taxpayer had no filing duties because of its lack of activity. Later, in the process of having their Forms 1040 prepared, the members identified the problem. They, in turn, notified the accountant, who filed an amended Form 1065 for the taxpayer reflecting certain activity, but still not enclosing Form 8996. The members subsequently hired another accounting firm, which underscored the missing Form 8996 problems.

PLR 202213007

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired accounting firm and "had a conversation" about filing Form 1065 and Form 8996. The accounting firm "orally" accepted the project. The accounting firm had a "standardized procedure" that it used for integrating all new clients, which led to clients being entered into the accounting firm's "workflow management system." The accountant heading up the taxpayer's project ignored procedure, though. As a result, the accounting firm overlooked the taxpayer, did not obtain an extension by filing Form 7004, and ultimately failed to file a timely Form 1065 and Form 8996.

PLR 202214001

The taxpayer was a partnership formed for purposes of being a QOF. An employee of one of the members of the taxpayer customarily communicated with the accounting firm each year about all affiliated entities for which Form 7004 should be filed. The accounting firm assured the employee that it had filed all necessary Forms 7004, such that the employee did not send it a list. After the filing deadline had passed, the employee realized that the taxpayer was not among those entities for which the accounting firm had filed Form 7004 and notified accounting firm of the issue. The taxpayer claimed that the miscommunication between the employee and the accounting constituted "circumstances beyond [its] control," which should justify the late filing of Form 1065 and Form 8996.

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[50] Government Accountability Office. Opportunity Zones: Data on Investment Activity and IRS Challenges Ensuring Taxpayer Compliance. GAO-22-105526 (Nov. 2021), pg. 3, footnote 6; Congressional Research Service. Tax Incentives for Opportunity Zones. Report R45152 (April 26, 2022), pg. 14.

[51] U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Oversight. Hearing on the Opportunity Zone Program and Who It Left Behind. November 16, 2021.

[52] U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Oversight. Hearing on the Opportunity Zone Program and Who It Left Behind. November 16, 2021. Comments by Bill Pascrell, Representative of New Jersey, Chairman of the Subcommittee on Oversight.

[53] Jonathan Curry. "Wyden Launches Probe of Opportunity Zone Investors," 2022 Tax Notes Today Federal 10-1 (Jan. 14, 2022) (see attached letters to various companies).

[54] Treasury Inspector General for Tax Administration. Additional Actions Are Needed to Address Qualified Opportunity Zone Fund and Investor Noncompliance. Report 2022-40-018 (Feb. 2022), pg. 7; *See also* Jonathan Curry, "IRS Lacks Plan for Keeping Opportunity Zone Investors in Line," 2022 Tax Notes Today Federal 29-2 (Feb. 11, 2022); TD 9889, Preamble, pg. 130; Treas. Reg. § 1.1400Z2(d)-1(a)(4).

[55] Government Accountability Office. Opportunity Zones: Census Tract Designations, Investment Activities, and IRS Challenges Ensuring Taxpayer Compliance. GAO-22-104019 (Oct. 2021), pg. 50; Internal Revenue Service. IRS Letters Going Out to Taxpayers Who May Need to Take Action Related to Qualified Opportunity Funds. Information Release IR-2022-29 (April 12, 2022); Jonathan Curry, "IRS Puts Questionable Opportunity Funds on Notice," 2022 Tax Notes Today Federal 71-1 (April 13, 2022).

PLR 202215012

The taxpayer was a partnership formed for purposes of being a QOF. Two members, a married couple, owned the partnership. An accounting firm had previously prepared Forms 1040 for the members, so they hired it to handle the return filings for the taxpayer, too. The members sent tax-related data about the taxpayer to the accounting firm, including an indication that it should seek an extension by filing Form 7004, and "assumed" that the accounting firm would take all steps necessary to maintain tax compliance thereafter. At some point after the original deadline for Form 1065 and Form 8996 had passed, the members contacted the accounting firm to check the status. The accounting firm explained that the accountant previously handling their matters had left, it lacked capacity to handle the taxpayer's filing, and it was not taking responsibility for any unfiled returns. The members, therefore, hired a new accountant, who filed Form 1065 and Form 8996 for the taxpayer late.

PLR 202217004

The taxpayer was a partnership formed for purposes of being a QOF. The manager of the taxpayer researched the requirements for QOFs, attended several seminars, and met with an accountant. The accountant, who had a "fantastic reputation," and whom the manager trusted based on personal experience, was in the process of selling his practice. The manager hired the accountant to handle return preparation for the partnership. For some reason, the manager prepared Form 8996, while the accountant prepared Form 1065. The accountant's tax software did not have updates for Form 8996 at the time, so he agreed to use the one completed by the manager. However, when the accountant later filed Form 1065, he "inadvertently neglected" to enclose Form 8996. After the accountant sold his practice, the new owner contacted the manager to inform him that the accounting firm could no longer service the taxpayer because it did not have expertise with QOFs. The manager, therefore, hired a new tax advisor. He noticed the problems the following year when doing his review.

PLR 202219001

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired accounting firm and informed it of the desire to be a QOF. The accountant leading the taxpayer's project said that he was overburdened at the time and needed to file Form 7004 for the taxpayer. Later, the accounting firm informed the taxpayer that the accountant was leaving the firm and would be replaced. The new accountant quickly observed that the original accountant never filed Form 7004, as promised. Therefore, the new accountant prepared and filed a late Form 1065 and Form 8996.

PLR 202223012

The taxpayer was a partnership formed for purposes of being a QOF. The taxpayer hired a firm comprised of two different teams, the Consulting Team and Tax Compliance Team. The taxpayer gave the Consulting Team a copy of its Operating Agreement, which emphasized its intent to be a QOF. The taxpayer understood that the Tax Compliance Team would handle return-filing matters. Given the scope of services negotiated with the firm, the taxpayer "reasonably expected" that the Consulting Team would adequately convey to the Tax Compliance Team data about QOF matters. However, because of "miscommunications," the Tax Compliance Team failed to enclose Form 8996 with the timely Form 1065.

PLR 202229033

The taxpayer was a partnership formed for purposes of being a QOF. Representatives of the taxpayer hired a return preparer, informed him of the taxpayer's intent to be a QOF, and sent him a list of items to discuss during an upcoming meeting, including return-filing obligations. After the meeting, the representatives sent the return preparer an e-mail summarizing various financial, tax, and accounting matters addressed. Later, the return preparer informed the taxpayer that because of an "administrative error," he had neither filed Form 7004 to extend the deadline, nor filed Form 1065 and Form 8996. Soon thereafter, the taxpayer consulted an attorney and an accounting firm, which assisted in filing the late returns.

PLR 202230001

The taxpayer was a partnership formed for purposes of being a QOF. The managing member hired firm 1 to prepare his Forms 1040, as well as the returns for various entities in which he had a controlling interest. The managing member hired firm 2 to prepare returns for entities related to his real estate fund business. Because of "communication errors," firm 1 erroneously believed that the managing member had tasked firm 2, not firm 1, with preparing Form 1065 and Form 8996 for the taxpayer. Firm 1 filed all returns, late, after the mix-up was identified.

Incipient Enforcement and Oversight Actions

Various governmental reports indicate that violations in the QOZ arena are commonplace. For instance, more than six percent of QOFs counted improper assets in determining whether they meet the eligibility standards in the first place.[48] Investors have their shortcomings, too. The reports indicate that a "material percentage" of Forms 8997 filed by investors have "obvious and blatant inaccuracies."[49]

Many predicted that IRS enforcement would not begin until 2026, the year in which investors were required to pay taxes on Rollover Gain. However, based on the statistics mentioned above and other early concerns, the IRS, with participation by Congress, has accelerated that timeline, beginning several enforcement and oversight actions already. First, members of Congress have introduced QOZ legislation aimed at fortifying oversight, transparency and accountability.[50] Such proposed legislation is grounded in the notion that the rules need to be better crafted by Congress and better enforced by the IRS. Second, the Committee on Ways and Means held a hearing on the status of the QOZ program.[51] The Chairman set the tone for such hearing, publicly pondering whether "the IRS even can tell if the participants in the program are complying with the rules"[52] Third,

the Senate Finance Committee launched an investigation of QOZs because of supposed abuse.[53] Fourth, the IRS announced its plan to issue regulations describing circumstances that would trigger decertification of QOFs and, likely, elimination of related tax benefits for their investors.[54] Finally, the IRS has quietly initiated scrutiny of QOFs and investors. The IRS, for example, has disseminated "education letters" to taxpayers whose initial returns were problematic, started examining "random samples" of returns to identify noncompliance trends, and sent "warning letters" to QOFs and investors with missing, incomplete or inaccurate Forms 8996 and Forms 8997, respectively, threatening them with audits, loss of tax benefits, and penalties.[55]

Conclusion

The news is largely positive to this point. The QOZ program has sparked considerable investment in low-income communities that ordinarily would have gone elsewhere, the IRS has published guidance on various aspects of the program, and, as this article highlights, the IRS has been abnormally flexible in granting PLRs allowing entities to obtain QOF treatment and investors to defer income taxes on Rollover Gain. However, this pleasant period might be ending soon, with the recent introduction of various enforcement and oversight actions by the IRS and Congress. QOFs and investors would be wise to retain specialized tax defense counsel soon, as governmental attention continues to rise. ■