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COVID-19 RELIEF FOR OPPORTUNITY ZONE FUNDS AND INVESTORS

ADAM WALLWORK AND GARY HECIMOVICH*¹

ABSTRACT

This Article describes how temporary changes to the qualified opportunity zone (QOZ) tax incentive, combined with new reliance regulations that clarify the requirements for qualified opportunity zone businesses (QOZBs) to modify their written plans to expend working capital in response to the ongoing coronavirus emergency, will make more individuals and entities eligible for federal tax stimulus by increasing flexibility for the qualified opportunity funds (QOFs) and QOZBs in which they invest to redeploy their capital into qualifying business development projects in a QOZ.

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¹ This Article does not constitute tax, legal, or other advice from Deloitte Tax LLP, which assumes no responsibility with respect to assessing or advising the reader as to tax, legal, or other consequences arising from the reader's particular situation.

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I. INTRODUCTION

Federal tax incentives for qualified opportunity zones (“QOZs”) under sections 1400Z-1 and 1400Z-2 of the Internal Revenue Code of 1986, as amended (the “Code”), aim to encourage economic growth and investment in distressed areas by providing economic stimulus to businesses operating within designated boundaries.² The targeted areas are those that satisfied certain eligibility criteria³ and were selected by governors of states and territories and the mayor of Washington, D.C., in 2018 to receive the federal tax benefits of the economic development program for QOZs.⁴ The federal tax benefit under the QOZ program flows to investors who timely roll over certain capital gains and section 1231 gains from prior investments (“eligible gain”) into specialized investment vehicles called qualified opportunity funds (“QOFs”). These funds invest in qualified opportunity zone businesses (“QOZBs”) and business

² See Joint Comm. on Taxation, “*Description of the Chairman’s Modification to the Chairman’s Mark of the ‘Tax Cuts and Jobs Act,’*” JCX-56-17, at 53 (Nov. 14, 2017); see also H.R. REP. No. 115-466, 115th Cong., 1st Sess., at 537–38 (Dec. 15, 2017).

³ Generally, QOZ benefits are limited to investments in certain low-income communities with 20% or greater poverty rates or median family income less than 80% of the statewide median family income. See I.R.C. § 1400Z-1(a); I.R.C. § 1400Z-1(c)(1); I.R.C. § 45D(e).

⁴ See I.R.C. § 1400Z-1(b)(1)(A)–(B) (providing for the nomination and designation of low-income communities and certain surrounding census tracts as qualified opportunity zones by the chief executive officers of each state and the U.S. Treasury Secretary); § 1400Z-1(c)(1) (defining “low-income community” by reference to the definition of the term under I.R.C. § 45D(e) for purposes of the new markets tax credit program); Rev. Proc. 2018–16, 2018–9 I.R.B. 383 (providing procedures for census tracts to be nominated and designated by chief executive officers of states).

property (“QOZ Business Property”) located in a QOZ.⁵ Taxpayers that invested in a QOF during 2021 can defer a corresponding amount of eligible gain realized until 2026, unless the QOF investment is sold earlier, and reduce by 10% the amount of deferred gain recognized in 2026 by holding the investment for at least five years.⁶ The benefit available to taxpayers who make a qualifying investment of deferred gain in a QOF and hold the investment for 10 years is the ability to exclude post-acquisition appreciation from income upon a sale or exchange of an interest in the QOF through December 31, 2047.⁷ This step-up in the basis of the QOF investment to fair market value after a 10-year holding period is valuable even if the QOF interest does not appreciate, since a step-up to fair market value covers both economic appreciation and reversal of tax depreciation, eliminating recognition of taxable gain at the time of a later sale or exchange.⁸

The U.S. Department of the Treasury and the Internal Revenue Service (“IRS”) issued final regulations on opportunity zone tax incentives on December 20, 2019, which were corrected by amendments issued on April 1, 2020.⁹ These regulations clarified the ground rules for taxpayers that invest new capital (through QOFs) in operating businesses, as well as real estate enterprises, in a QOZ to realize the tax deferral and reduction benefits that flow from such investment.¹⁰ Within three months, however, widespread economic hardship spread throughout the United States in the wake of the ongoing Coronavirus Disease 2019 (COVID-19) pandemic, with restaurants, bars, gyms, malls, retail stores and other customer-facing businesses shuttered to minimize the public’s exposure to the virus.¹¹ The White House Council

⁵ See I.R.C. § 1400Z-2(a)(1)(A) (restricting benefits under the QOZ program to those who invest in a QOF within 180 days of realizing gain from a sale or exchange of property to an unrelated person); § 1400Z-2(d)(1) (defining QOFs in which taxpayers must invest); § 1400Z-2(d)(2) (describing “qualified opportunity zone property” in which a QOF must reinvest 90% of its assets); § 1400Z-2(d)(3) (setting forth organizational requirements for qualified opportunity zone businesses that issue qualified opportunity zone stock and qualified opportunity zone partnership interest); 26 C.F.R. § 1.1400Z2(d)-1(a)(1) (2021) (setting forth requirements for “eligible entities,” which are domestic corporations and partnerships, together with those organized in U.S. territories, which, under certain circumstances, can elect to be a QOF or be treated as a QOZB).

⁶ I.R.C. § 1400Z-2(b) (providing for deferral of gain rolled over into a QOF); Treas. Reg. § 1400Z-2(b)(2)(B)(iii) (providing a basis increase in the QOF investment of 10% of the deferred gain after a five-year holding period).

⁷ I.R.C. § 1400Z-2(c) (authorizing an elective increase in a taxpayer’s tax basis in a QOF investment to fair market value in the case of an investment held for at least 10 years); Treas. Reg. § 1.1400Z2(c)-1(c) (2020) (extending the availability of the fair market value basis election to dispositions occurring on or before December 31, 2047).

⁸ See Treas. Reg. § 1.1400Z2(c)-1(b)(1)(i) (2020); § 1.1400Z2(c)-1(b)(1)(iii) (2020).

⁹ INVESTING IN QUALIFIED OPPORTUNITY FUNDS, T.D. 9889, 85 Fed. Reg. 1,866–2,001 amended by 85 Fed. Reg. 19,082–87 (Apr. 6, 2020).

¹⁰ *Id.*

¹¹ See generally THE WHITE HOUSE COUNCIL OF ECON. ADVISERS, EXEC. OFF. OF THE PRESIDENT, THE IMPACT OF OPPORTUNITY ZONES: AN INITIAL ASSESSMENT at 2 (Aug. 2020)

of Economic Advisors noted in a report released in August 2020 that “[t]he COVID-19 pandemic slowed investment everywhere in the second quarter of 2020, including in Opportunity Zones, but the initial evidence suggests that the [Q]OZ model has power to mobilize investors; engage State, local and tribal stakeholders; and improve the outlook for low-income communities—all with limited prescription from the Federal Government.”¹² Prior to the pandemic, taxpayers invested an estimated \$75 billion in QOFs during 2018 and 2019.¹³ QOFs must timely reinvest these funds in qualifying ownership interests in QOZB operating businesses or QOZ Business Property used in a business in a QOZ in order to avoid penalties.¹⁴

In response to the COVID-19 pandemic, the IRS issued Notice 2021-10, 2021-7 IRB 888 (Feb. 16, 2021) to ensure that opportunity zone tax incentives will continue to bring new business expansion and development to economically distressed communities in the United States.¹⁵ Notice 2021-10 extends relief originally provided to QOFs and their investors and QOZB operating businesses under Notice 2020-39, 2020-26 I.R.B. 984 (Jun. 22, 2020) that expired in 2020.¹⁶ It also applies to further extend the time period for taxpayers who realized gain on sales or exchanges of business property in 2019 to reinvest that gain in a tax-deferred QOF investment under IRS updates to Qualified Opportunity Zones Frequently Asked Questions (“FAQs”), released contemporaneously with Notice 2020-39.¹⁷ More specifically, Notice 2021-10 makes five changes to the QOZ Program that will make more taxpayers eligible for tax stimulus under the QOZ Program and increase flexibility for QOFs and their respective QOZB subsidiaries required to redeploy their capital into qualifying business development projects in a QOZ.¹⁸ This notice extends the automatic relief originally provided under Notice 2020-39 by:

- (1) Extending until March 31, 2021, the 180-day period for electing taxpayers (including, among others, individuals, partnerships, corporations, trusts and estates) who recognized certain eligible capital gain on or after October 5, 2019, to roll over such gain into a QOF investment in order to defer, and in some cases permanently reduce, the gain that would otherwise have been

(noting that COVID-19 slowed investments across the American economy, including in QOZ census tracts).

¹² *Id.*

¹³ *Id.* at 15–16.

¹⁴ I.R.C. § 1400Z-2(f)(1).

¹⁵ I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021).

¹⁶ *Id.* at 890 *amplifying* I.R.S. Notice 2020–39, 2020–26 I.R.B. 984 (Jun. 22, 2020), and *modifying* I.R.S. Notice 2020–23, 2020-18 I.R.B. 742 (Apr. 27, 2020).

¹⁷ *See id.* at 890; I.R.S., *Opportunity Zones Frequently Asked Questions*, <https://www.irs.gov/credits-deductions/opportunity-zones-frequently-asked-questions> (Nov. 2, 2021) (“Can I defer 1231 gain for a taxable year under the QOF Rule? . . . If your 1231 gain was realized in 2019, your 180-day period may begin on December 31, 2019.”).

¹⁸ Notice 2021-10, *supra* note 15, at 890.

recognized in the 2019 or 2020 tax year if a deferral election had not been made (the “*extension of the 180-day investment period*”);¹⁹

- (2) Eliminating 2020 and 2021 penalties imposed on certain QOFs that failed to hold on average at least 90% of their assets in QOZ property (the “90% investment standard”), including qualifying direct and indirect investments through a QOZB in QOZ Business Property (collectively, “QOZ Property”), if either (1) the last day of the QOF’s tax year falls between April 1, 2020 and June 30, 2021, or (2) the last day of the first six-month period of the QOF’s tax year falls between April 1, 2020 and June 30, 2021 (the “*waiver of the 90% investment standard*”);²⁰
- (3) Extending for an additional 24 months the working capital safe harbor period for QOZBs that have a written working capital plan and schedule in place during any period between January 20, 2020 and June 29, 2021, including both the initial 31-month working capital safe harbor period (for a maximum initial safe-harbor period of 55 months) and the cumulative 62-month working capital safe harbor if an integrated plan is used (for a maximum cumulative safe-harbor period of 86 months) (the “*extension of the 31-month working capital safe harbor period*”);²¹

¹⁹ See *id.* at 888 (extending the 180-day deadline for taxpayers to invest in QOFs with respect to eligible gains); § 1400Z-2(a)(1)(A) (restricting the eligibility for deferral under the QOZ program to “so much of [the eligible] gain as does not exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of [a] sale or exchange” of property held by the taxpayer to an unrelated person).

²⁰ See Notice 2021-10, *supra* note 15, at 890 (deeming QOFs with semiannual testing dates, within the meaning of section 1400Z-2(d)(1)(A) and (B), to have reasonable cause for failing to maintain their 90% investment standard, as required by section 1400Z-2(f)(3) for purposes of avoiding penalties); § 1400Z-2(f)(1) (imposing penalties on QOFs that fail to maintain a minimum 90% of their assets in QOZ property, as defined in section 1400Z-2(d)(2)(A)); § 1400Z-2(f)(3) (exempting from penalties taxpayers showing reasonable cause for failing to maintain the 90% investment standard).

²¹ See Notice 2021-10, *supra* note 15, at 890; 26 C.F.R. § 1.1400Z2(d)-1(d)(3)(vi) (2021) (providing, with an exception for federally-declared disasters, the basic 31-month working capital safe harbor for certain trades or business to exclude from the definition of nonqualified financial property, as defined in section 1397C(e)(1) for purposes of sections 1397C(b)(8) and 1400Z-2(d)(3)(A)(ii), certain working capital assets, held as cash, cash equivalents and debt instruments with a term of 18 months or less, if spent in accordance with a written plan and schedule); § 1.1400Z2(d)-1(d)(3)(vi)(A) (2021) (providing conditions under which the 31-month working capital safe harbor period may be extended to a maximum of 62 months); § 1.1400Z2(d)-1(d)(3)(vi)(B) (2021) (providing an exception during the working capital safe harbor period(s) of an entity treated as a QOZB to the 50% gross income requirement with respect to income earned from operating an active trade or business in a QOZ); 26 C.F.R. § 1.1400Z2(d)-1(d)(3)(ii)(A) (2021) (providing an exception during the working capital safe harbor period(s) of a QOZB to the requirement that 40% of a business’s intangible property be used in a trade or business in a QOZ); § 1.1400Z2(d)-1(d)(3)(vi)(D)(1) (2021) (providing that, if property is treated as working capital for purposes of the nonqualified financial property test,

- (4) Tolling from April 1, 2020 through March 31, 2021, the 30-month substantial improvement period (for a maximum substantial improvement period of 42 months) in which a QOF or QOZB that was not the first person to use tangible property in a QOZ may qualify the property as QOZ Business Property by making additions to the basis of tangible property exceeding 100% of the property's adjusted basis at the beginning of any 30-month period commencing on or after the date that the property was acquired (the "*extension of the 30-month substantial improvement period*");²² and
- (5) Extending for an additional 12 months the QOF reinvestment safe harbor period in which QOFs that received a return of capital from an investment in QOZ Property or proceeds from the sale or disposition of such property between January 20, 2019 and June 30, 2020, may reinvest the proceeds in QOZ Property and treat the proceeds held in cash or cash equivalents as invested in QOZ Property throughout the applicable 24-month period for purposes of satisfying the 90% investment standard, so long as the QOF invests the proceeds in the same manner as it originally intended prior to June 30, 2020 (the "*extension of the 12-month reinvestment period*").²³

This Article and the table included at the end provide a detailed summary of the automatic relief provided to QOFs and their investors and QOZB operating businesses under Notice 2021-10. The five key takeaways from this guidance are as follows:

- (1) The extension of the 180-day investment period applies retroactively to 2019, meaning taxpayers that have already filed their 2019 federal income tax returns and did not elect to defer eligible gain or make investments in QOZs through a QOF may still do so by making the election to defer gain on an amended 2019 federal income tax return provided this gain amount was invested in a QOF by March 31, 2021.²⁴ This will permit certain taxpayers to

the QOZB is exempt from the requirement that 70% of the business's assets be held in the form of QOZ Business Property for the duration of the working capital safe harbor).

²² Notice 2021-10, *supra* note 15, at 890. As set forth in section 1400Z-2(d)(1), a QOF must invest 90% of its assets in QOZ property, including QOZ Business Property, and a QOZB must invest "substantially all" of its tangible property in QOZ Business Property, which Treas. Reg. § 1.1400Z2(d)-1(d)(2)(i) defines to mean 70% of the tangible property owned or leased by the trade or business. *See also* I.R.C. §§ 1400Z-2(d)(1), (2)(A), (3)(A)(i) (2021).

²³ *See* Notice 2021-10, *supra* note 15, at 890; § 1400Z-2(e)(4)(B) (2020) (expressly authorizing regulations to ensure QOFs have sufficient time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, as defined in section 1400Z-2(d)(2)(B) and (C), respectively, and to reinvest proceeds received from a sale or exchange of qualified opportunity zone property, as defined in section 1400Z-2(d)(2)(A)); 26 C.F.R. § 1.1400Z2(f)-1(b) (establishing a general period of 12 months to reinvest such proceeds, with an exception for federally declared disasters, under which the 12-month reinvestment period may be extended to 24 months).

²⁴ *See* I.R.C. § 1400Z-2(a)(1)(A) (2020); Notice 2021-10, *supra* note 15, at ii.

claim refunds for 2019 while investing like amounts in tax-advantaged QOZ investments.

- (2) The waiver of the 90% investment standard permits all QOFs self-certified as a QOF on or before January 31, 2021, to abate any and all penalties that would otherwise be imposed in tax years 2020 and 2021 for failing to satisfy the 90% investment standard including with respect to investments made in QOZBs that fail to satisfy QOZB requirements during this period.²⁵ QOFs funded with tax deferred proceeds by January 31, 2021, that will no longer be moving forward with QOZ investments should consider dissolving or otherwise decertifying (including retroactively) on or before December 31, 2021, in order to apply the waiver and avoid penalty.²⁶
- (3) The extension of the 31-month working capital safe harbor permits QOZBs to significantly extend the period of time (up to 86-months in some cases) before the commencement of operations must begin, allowing more patient capital to be raised. In order for the extension to be provided, a written plan and schedule must have been established by the QOZB that includes some or all of the period between January 20, 2020 and June 29, 2021.²⁷ All current QOZBs should also reevaluate their working capital plan documentation for tax years beginning after 2019 to ensure qualification for this extension in light of proposed regulations (REG-121095-19) published in the Federal Register on April 14, 2021,²⁸ that, among other things, provide additional

²⁵ See Notice 2021-10, *supra* note 15, at 890; I.R.S., *Instructions for Form 8996*, INTERNAL REVENUE SERV., 5 (Dec. 2021) (illustrating in Example 3 the application of the 90% investment standard's semiannual testing date in the case of a partnership formed in January 2021).

²⁶ 26 C.F.R. § 1.1400Z2(d)-1(a)(3) (2021) allows a QOF to choose to self-decertify as a QOF "in such form and manner as may be prescribed by the Commissioner [of Internal Revenue] in IRS forms or instructions or in publications or guidance published in the Internal Revenue Bulletin." While the IRS provided a check-the-box election to self-decertify as a QOF on Line 6 of Part I of the November 5, 2020, draft of Form 8996, Qualified Opportunity Fund, that election was eliminated in the final version of Form 8996 released in February 2021. Line 6 of Part I of Form 8996 has been reserved, however, and presumably a self-decertification election will be made available in subsequent versions of the form, which may include retroactive decertification elections. Letter from John Sciarretti, Novogradic LLP, to Paul Adams, I.R.S. (Nov. 16, 2021) (on file with *Cleveland State Law Review*); see I.R.S. Form 8996, Qualified Opportunity Fund (Dec. 2021); I.R.S. *Instructions for Form 8996*, *supra* note 25.

²⁷ See Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D) (2021) (authorizing up to 24 additional months for a QOZB to consume its working capital assets in the case of a federally-declared disaster); Notice 2021-10, *supra* note 15, at 890 (invoking this 24-month extension of the working capital safe harbor period in the case of all QOZBs intending to expend working capital between January 20, 2020, and June 29, 2021).

²⁸ I.R.S. Notice of Proposed Rulemaking: Requirements for Certain Foreign Persons and Certain Foreign-Owned Partnerships Investing in Qualified Opportunity Funds and Flexibility for Working Capital Safe Harbor Plans, Reg-121095-19, 86 Fed. Reg. 19,585, 19,590, 19,597 (Apr. 14, 2021) (containing additional guidance regarding the 24-month extension of the

guidance on which QOZBs may rely until final rules are published regarding the 24-month extension of the working capital safe harbor in the case of federally declared disasters, including those declared because of the COVID-19 outbreak in every jurisdiction of the United States as of January 20, 2020.²⁹ These proposed regulations add additional flexibility for QOZBs to modify or replace their original, pre-disaster written designation in which the amount of working capital assets subject to the safe harbor are designated, as well as the original, pre-disaster written schedule for expending such amounts.³⁰ They allow the QOZB to make modifications to their existing working capital plans and schedules, in light of the post-disaster environment facing the QOZB due to the COVID-19 emergency, for up to 120 days after the close of the “incident period” identified by the Federal Emergency Management Agency (“FEMA”) with respect to the ongoing pandemic.³¹

- (4) The extension of the 30-month substantial improvement period permits QOFs and QOZBs to significantly extend the period of time (up to 42-months in some cases) before such entity has more than doubled the basis of property acquired where substantial improvements were occurring at any time between April 1, 2020 and March 31, 2021.³² For tangible property acquired during this period where substantial improvements also commence, the deadline for completing these substantial improvements is extended until September 30, 2023.
- (5) The extension of the 12-month reinvestment period permits QOFs an additional 12 months (24 months) to reinvest some or all of the proceeds received from a return of capital, sale, or other disposition of QOZ Property during the 18-month period occurring between January 20, 2019 and June

working capital safe harbor in the case of federally declared disasters on which taxpayers may rely until the final rule is promulgated for tax years beginning in 2020 or later).

²⁹ Federal Emergency Management Agency, U.S. Dep’t of Homeland Sec. Major Disaster Declarations; COVID-19 Pandemic, 87 Fed. Reg. 26,366–67 (May 4, 2022).

³⁰ See Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D); I.R.S. Notice of Proposed Rulemaking: Requirements for Certain Foreign Persons and Certain Foreign-Owned Partnerships Investing in Qualified Opportunity Funds and Flexibility for Working Capital Safe Harbor Plans, Reg-121095-19, 86 Fed. Reg. 19,590 (Apr. 14, 2021) (providing that the three sentences proposed to be added to the working capital safe harbor provision for federally declared disasters are effective until final rules are published in the Federal Register).

³¹ *Id.*

³² See 26 C.F.R. § 1.1400Z2(d)-2(b)(2) (setting forth the original use or substantial improvement requirement for QOZ Business Property); § 1.1400Z2(d)-2(b)(4) (“[D]uring the 30-month substantial improvement period[,] [t]he property has been substantially improved when the additions to basis of the property in the hands of the QOF [or QOZB] 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 [or QOZB] (substantial improvement requirement).”); Notice 2021-10, *supra* note 15 (extending this 30-month substantial improvement period for the period between April 1, 2020 and March 31, 2021).

30, 2020.³³ Only QOFs that received a return of capital or sale or disposition proceeds from QOZ Property by June 30, 2020, will qualify for a 24-month reinvestment period.³⁴ For example, a QOF that received a return of capital on June 30, 2020, would have until June 30, 2022 (24 months later) to reinvest the proceeds in QOZ Property, without those assets jeopardizing the 90% investment standard.³⁵ But a QOF that received a return of capital on July 1, 2020, would only have until July 1, 2021 (12 months later) to reinvest, because the QOF's original 12-month reinvestment period did not include June 30, 2020.³⁶ QOFs that overcapitalized QOZBs should evaluate whether a return of capital received by June 30, 2020, for redeployment in QOZ Property within 24 months would be prudent given the additional time available to reinvest such proceeds.

II. ORIGINS OF QUALIFIED OPPORTUNITY ZONES

On December 22, 2017, Congress authorized the creation of “qualified opportunity zones” as part of the 2017 tax reform legislation, popularly known as the Tax Cuts and Jobs Act of 2017 (“TCJA”),³⁷ and later expanded its scope to include most of Puerto Rico under the Bipartisan Budget Act of 2018.³⁸ Section 1400Z-1 of the Internal Revenue Code of 1986, as amended, provides for the designation of certain economically distressed communities, where under certain conditions set forth in section 1400Z-2, new investments may be eligible for preferential tax treatment.³⁹ A total of 8,764 QOZ census tracts have been designated in all 50 states, the District of Columbia and five U.S. territories to spur economic development by providing tax incentives for investors who invest new capital in businesses operating in one or more

³³ See § 1.1400Z2(f)-1(b) (providing the general 12-month reinvestment period for QOFs that receive proceeds from an investment in QOZ Property, as well as the 12-month extension for federally declared disasters); Notice 2021-10, *supra* note 15, at 890 (extending this 12-month QOF reinvestment period to 24 months in certain circumstances).

³⁴ Notice 2021-10, *supra* note 15, at 890.

³⁵ *Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic*, INTERNAL REVENUE SERV. 8–10, <https://www.irs.gov/pub/irs-drop/n-20-39.pdf> (last visited Aug. 28, 2022).

³⁶ *Id.*

³⁷ Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2184, § 13823.

³⁸ Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64, 161 § 41115 (Feb. 9, 2018) (codified as amended, at § 1400Z-1(b)(3)).

³⁹ I.R.C. §§ 1400Z-1, 1400Z-2, added by the legislation commonly known as the Tax Cuts and Jobs Act, *supra* note 37, at § 13823(a), as modified by Bipartisan Budget Act of 2018, *supra* note 38 (codified as amended at sections 1400Z-1(b)(3)).

QOZs.⁴⁰ Approximately 11% of the U.S. population lives in a QOZ,⁴¹ and nearly 12% of all inhabited census tracts in the United States are QOZs.⁴²

The QOZ program is intended to encourage investment in distressed communities by providing federal tax benefits to investors, through QOFs, in “low-income communities,” as defined by section 45D(e) of the Code, which requires that a population census tract satisfy one of the following criteria for economic distress:⁴³

- (1) The poverty rate for the tract is at least 20%;⁴⁴
- (2) For a tract not located in a metropolitan area, the median family income for the tract does not exceed 80% of the statewide (or possessionwide) median family income;⁴⁵
- (3) For a census tract in a metropolitan area, the median family income for the tract does not exceed 80% of the greater of (a) the statewide (or

⁴⁰ See DESIGNATED QUALIFIED OPPORTUNITY ZONES UNDER INTERNAL REVENUE CODE § 1400Z-2, Notice 2018-48, 2018-28 I.R.B. 9 (Jul. 9, 2018) (listing 8,762 census tracts designated as QOZs), as amplified by AMPLIFICATION OF NOTICE 2018-48 TO INCLUDE ADDITIONAL PUERTO RICO DESIGNATED QUALIFIED OPPORTUNITY ZONES, Notice 2019-42, 2019-29 I.R.B. 352 (Jul. 15, 2019) (adding two additional census tracts in Puerto Rico pursuant to automatic designation procedures under section 1400Z-1(b)(3)). See also John Sciarretti, *New Census Tract Data Raises Questions for OZ Stakeholders*, (Mar. 2, 2021, 12:00 AM) <https://www.novoco.com/notes-from-novogradac/new-census-tract-data-raises-questions-oz-stakeholders>.

⁴¹ Andrew Lee, et al., OPPORTUNITY ZONES GREAT POTENTIAL, POTENTIAL CHALLENGES, 26, UBS, 2019. See also Press Release, U.S. Dep’t. of the Treas., Treasury, IRS Announce Final Round of Opportunity Zone Designations (Jun. 14, 2018) (“Nearly 35 million Americans live in communities designated as Qualified Opportunity Zones.”).

⁴² U.S. Census Bureau, 8,764 QOZ census of 73,558 inhabited U.S. census tracts (11.91%). See Community Development Financial Institutions Fund (CDFI Fund), U.S. Dep’t of the Treas., List of Designated Qualified Opportunity Zones, (Dec. 14, 2018) (QOZs); U.S. Census Bureau, Annual Estimates of the Resident Population for the United States, Regions, States, and the District of Columbia: April 1, 2010 to July 1, 2020 (NST-EST2020), column O row 5 (listing the resident population of the United States as 329,484,123).

⁴³ See I.R.C. § 1400Z-1(a)–(e) (providing criteria for designation of low-income communities, together with certain of their contiguous tracts, as QOZs); 63 Cong. Rec. H9943-06, H10089-90 (Dec. 15, 2017) (explaining that opportunity zones are being established to allow for “the designation of certain low-income community population census tracts as qualified opportunity zones, where low-income communities are defined in Section 45D(e),” and provide “two main tax incentives to encourage investment in qualified opportunity zones.”) The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the tenth calendar year beginning on or after the date of designation.

⁴⁴ I.R.C. § 45D(e)(1)(A).

⁴⁵ § 45D(e)(1)(B)(i).

possessionwide) median family income or (b) the metropolitan area median family income;⁴⁶

- (4) The tract (a) has a population of less than 2,000, (b) is located in an empowerment zone and (c) is contiguous with a low-income community that has a poverty rate of at least 20% or a median family income that does not exceed 80% of the statewide median (or, if relevant, the metropolitan area median family income);⁴⁷ or
- (5) The tract (a) is located in a high-migration rural county with a net outward migration of at least 10% of the county's population during a 20-year period ending with the year in which the most recent census was conducted and (b) the median family income for the tract does not exceed 85% of the statewide (or possessionwide) median family income.⁴⁸

Nearly 98% of all QOZs satisfy the above criteria for being a low-income community;⁴⁹ the remaining 198 census tracts designated as QOZs are contiguous with a low-income community designated as a QOZ and have a median family income that does not exceed 125% that of the low-income community with which the tract is contiguous.⁵⁰

Electing taxpayers are able to defer, and in some cases permanently exclude, certain capital gains and section 1231 gains (generally arising from the disposition (including involuntary conversion) of depreciable or real property used in a business that is held for more than one year) realized on or before December 31, 2026, by investing in a QOF.⁵¹ To be eligible, within 180 days of an actual or deemed sale or exchange, the taxpayer must invest cash or other property in a QOF.⁵²

⁴⁶ § 45D(e)(1)(B)(ii).

⁴⁷ § 45D(e)(4).

⁴⁸ § 45D(e)(5).

⁴⁹ 8,566 of the 8,764 population census tracts that have been designated as QOZs are low-income communities within the meaning of I.R.C. §45D(e). *See* Community Development Financial Institutions Fund (CDFI Fund), U.S. Dep't of the Treas., List of Designated Qualified Opportunity Zones, (Dec. 14, 2018) (QOZs).

⁵⁰ U.S. GOV'T ACCOUNTABILITY OFF. GAO-22-104019, OPPORTUNITY ZONES CENSUS TRACT DESIGNATIONS, INVESTMENT ACTIVITIES, AND IRS CHALLENGES ENSURING TAXPAYER COMPLIANCE, (2021), at 16-17; DESIGNATED QUALIFIED OPPORTUNITY ZONES UNDER INTERNAL REVENUE CODE § 1400Z-2, *supra* note 40; AMPLIFICATION OF NOTICE 2018-48 TO INCLUDE ADDITIONAL PUERTO RICO DESIGNATED QUALIFIED OPPORTUNITY ZONES, *supra* note 40, (listing every designated qualified opportunity zone); *see also* § 1400Z-1(e) (limiting contiguous tracts other than low-income communities to not more than 5% of the population census tracts designated in a state, U.S. territory or the District of Columbia).

⁵¹ I.R.C. § 1400Z-2(a)(1)(A), (a)(2)(B), (b)(2)(B)(iii), (b)(2)(B)(iv).

⁵² *See* § 1400Z-2(a)(1)(A); 26 C.F.R. § 1.1400Z2(c)-1(b)(1) (2021) (restricting fair market value basis step up election after 10-year holding period to “[a]n eligible taxpayer who makes

A QOF is a partnership or corporation for tax purposes organized for the purpose of investing in QOZ Property, other than another QOF, that holds at least 90% of its assets in such property.⁵³ A QOF determines its compliance with the 90% investment standard based on the average of the percentages of QOZ Property held by the fund on the last day of the first six-month period of the entity's tax year and on the last day of the fund's tax year ("semiannual testing dates"), whichever is earlier.⁵⁴ A calendar year QOF will have testing dates on June 30 and December 31 every year after its first taxable year.⁵⁵ A QOF must elect to become a QOF on the initial Form 8996, *Qualified Opportunity Fund*, filed with a timely-filed federal income tax return (including filing extensions) for the first year in which the applicable entity intends to make the self-certification and for the initial QOF tax year and each subsequent tax year in which the QOF self-certification is effective.⁵⁶ The QOF must also annually complete IRS Form 8996 filed with a timely federal income tax return (including extensions) to either certify its compliance with the 90% investment standard for the tax year or compute a penalty owed on the shortfall each month based on the applicable federal income tax underpayment rate under section 6621(a)(1), computed quarterly by the IRS.⁵⁷

The QOF must use its capital to make qualifying investments in QOZs after 2017, comprised of either direct or indirect investments into the development of a trade or business in a QOZ, including when appropriate: (i) the acquisition, construction, and/or substantial improvement of commercial, residential and industrial buildings and equipment;⁵⁸ (ii) the renovation of buildings that have been continuously more

a deferral election with respect to, or acquires by reason of a transaction that is not an inclusion event, a qualifying investment in a QOF").

⁵³ I.R.C. § 1400Z-2(a)(1).

⁵⁴ §§ 1400Z-2(a)(1)(A)–(B).

⁵⁵ §§ 1400Z-2(a)(1)(A)–(B); I.R.S. *Instructions for Form 8996*, *supra* note 25, at 5.

⁵⁶ See 26 C.F.R. § 1.1400Z2(d)-1(a)(2) (2021); *Instructions for Form 8996*, *supra* note 25, at 1 ("A corporation or partnership uses Form 8996 to certify that it is organized to invest in QOZ property. In addition, a corporation or partnership files Form 8996 annually to report that the QOF meets the 90% investment standard of section 1400Z-2 or to figure the penalty if it fails to meet the investment standard."); I.R.S. Priv. Ltr. Rul. PLR-116527-20 (May 14, 2021); I.R.S. Priv. Ltr. Rul. PLR-126319-20 (May 21, 2021); I.R.S. Priv. Ltr. Rul. PLR-119294-20 (May 21, 2021); I.R.S. Priv. Ltr. Rul. PLR-124804-20 (Apr. 23, 2021); I.R.S. Priv. Ltr. Rul. PLR-117194-20 (Jan. 22, 2021); I.R.S. Priv. Ltr. Rul. PLR-118715-19 (May 8, 2020).

⁵⁷ I.R.S., Form 8996, *Qualified Opportunity Fund*, Part I, Lines 1–5 (Dec. 2021); *Instructions for Form 8996*, *supra* note 25.

⁵⁸ For special rules on newly constructed and newly-used property in a QOZ, see Amanda H. Nussbaum, et al., *Final Regulations on Opportunity Zones*, Tax Talks, (Jan. 22, 2020), https://www.proskauertaxtalks.com/2020/01/final-regulations-on-opportunity-zones/#_ftn75 (last accessed Sept. 13, 2022). See also 26 C.F.R. § 1.1400Z2(d)-2(b)(1)(iii) (2020) (discussing rules for self-constructed property); § 1.1400Z2(d)-2(b)(3) (2020) (discussing rules for treating used property as originally used in a QOZ for purposes of the QOZ Business Property requirements). For rules related to the substantial improvement of existing buildings and structures, see § 1.1400Z2(d)-2(b)(4) (2020).

than 80% vacant for at least three years (or one year since Treasury's announcement of the QOZ designation of the population census tract in which the building is located);⁵⁹ (iii) the production of new inventory;⁶⁰ (iv) investments to ensure the safety of brownfield sites,⁶¹ as defined by section 101 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980,⁶² and (v) the relocation of employees or other assets to leased facilities in a QOZ that satisfy the requirements for being considered QOZ Business Property.⁶³

Generally, QOFs invest in QOZ Business Property through first-tier subsidiaries that operate a QOZB in an opportunity zone, since such entities: (1) need only invest 70% of their tangible property in QOZ Business Property (the "70% tangible property standard");⁶⁴ (2) can hold unlimited amounts of intangible property so long as at least 40% of those intangibles are normally used in the performance of an activity in a QOZ that contributes to the generation of gross income for the business;⁶⁵ and (3) are

⁵⁹ With the exception of two Puerto Rican census tracts, 80% vacancy since July 8, 2018, the day before Treasury designated 8,762 of the 8,764 census tracts as QOZs, would apparently suffice in the absence of three years' vacancy. *See* § 1.1400Z2(d)-2(b)(3)(iii) (2020) (defining vacancy to mean more than 80% of the real property, including land and buildings, is not currently being used, as measured by the square footage of usable space); § 1.1400Z2(d)-2(b)(3)(i)(B) (2020) (treating property as satisfying the original-use requirement for QOZ Business "[i]f real property, including land and buildings, has been vacant for an uninterrupted period of at least" (i) "one calendar year beginning on a date prior to the date on which the qualified opportunity zone in which the property is located is listed as a designated qualified opportunity zone in a QOZ designation notice," or (ii) "three calendar year period beginning on a date after the date of publication of the QOZ designation notice that lists as designated the qualified opportunity zone in which the property is located," so long as "the property has remained vacant through the date on which the property was purchased by the eligible entity [i.e., the QOF or QOZB]", and is thereafter originally placed in service for purposes of depreciation or amortization by such entity); DESIGNATED QUALIFIED OPPORTUNITY ZONES UNDER INTERNAL REVENUE CODE § 1400Z-2, *supra* note 40 (designating 8,762 QOZ census tracts); AMPLIFICATION OF NOTICE 2018-48 TO INCLUDE ADDITIONAL PUERTO RICO DESIGNATED QUALIFIED OPPORTUNITY ZONES, *supra* note 40 (designating two more QOZs in Puerto Rico).

⁶⁰ § 1.1400Z2(d)-2(b)(2)(ii) (2020) (treating inventory produced by a trade or business in a QOZ after 2017 as QOZ Business Property if used for at least 70% of the time, during at least 90% of its holding period in a QOZ, prior to its sale to customers).

⁶¹ For special rules treating investments in brownfield sites as QOZ property, *see* Treas. Reg. § 1.1400Z2(d)-2(b)(3)(iv).

⁶² 42 U.S.C. § 9601.

⁶³ For special rules on leased facilities from related and unrelated persons, *see* 26 C.F.R. § 1.1400Z2(d)-2(c) (2020).

⁶⁴ I.R.C. § 1400Z-2(d)(3)(A)(i) (requiring that "substantially all" of the tangible property of a QOZB be QOZ Business Property, determined by substituting "qualified opportunity zone business" for "qualified opportunity fund" each time that term appears in section 1400Z-2(d)(2)(D)); 26 C.F.R. § 1.1400Z2(d)-1(d)(2)(i) (2021) (defining "substantially all" for this purpose to mean 70% of the QOZB's tangible property).

⁶⁵ I.R.C. § 1400Z-2(d)(3)(A)(ii) (incorporating, as modified, the requirement in section 1397C(b)(4) that a "substantial portion" of the eligible entity's intangible property for each

eligible for a working capital safe harbor (“WCSH”) that effectively protects new businesses from having to satisfy various financial, tangible and intangible property and gross income requirements for up to 62 months (extended to 86 months under Notice 2021-10).⁶⁶ QOZ Business Property is generally defined as new or substantially improved tangible property acquired by purchase from an unrelated person or leased after 2017 for use in a trade or business in a QOZ, with respect to which at least 70% of the use is in a QOZ for at least 90% of the QOF’s or QOZB’s holding period for such property.⁶⁷ For this purpose, an “unrelated person” is generally defined as an individual or entity that is less than 20% related to the QOF or QOZB purchasing the tangible property, using familial and constructive ownership rules otherwise set forth in section 267(b) and 707(b)(1) of the Code.⁶⁸ “Substantial improvement” requires an eligible entity to make capital improvements to tangible property over a 30-month period that more than double the adjusted tax basis of such property at the beginning of such period.⁶⁹

The 70% tangible property standard for QOZBs gives QOFs an incentive to invest in a QOZB rather than owning QOZ Business Property directly.⁷⁰ Because a QOF can satisfy its 90% investment standard by investing 90% of its assets in QOZ Property, including QOZ stock or a QOZ partnership interest in a QOZB, which holds 70% of its tangible property in QOZ Business Property, only 63% of the qualifying investments by tax-deferred investors in a QOF needs to be invested in an opportunity zone to qualify the investors for the beneficial tax treatment provided for investments in QOFs under a two-tier structure.⁷¹ By contrast, if a QOF invested its assets directly in QOZ Business Property, rather than through a QOZB, 90% of its total assets (not

taxable year be used in the active conduct of a trade or business in a QOZ); 26 C.F.R. §1.1400Z2(d)-1(d)(3)(ii)(A) (2021) (defining a “substantial portion” to mean 40%); § 1.1400Z2(d)-1(d)(3)(ii)(B) (2021) (defining the use of intangible property by a QOZB in the active conduct of a trade or business in a QOZ to mean (A) the use of such property is normal, usual or customary in the conduct of the trade or business, and (B) the intangible property is used in a QOZ in the performance of an activity that generates gross income within or outside the QOZ).

⁶⁶ § 1.1400Z2(d)-1(d)(3)(v) (2021); § 1.1400Z2(d)-1(d)(3)(vi)(B) (2021) (safe harbor for 50% gross income derived from an active trade or business within a QOZ); § 1.1400Z2(d)-1(d)(3)(vi)(C) (2021) (safe harbor for use of 40% of intangible property in active trade or business in a QOZ); § 1.1400Z2(d)-1(d)(3)(vi)(D) (2021) (safe harbor for 70% tangible property standard); Notice 2021-10, *supra* note 15, at 890.

⁶⁷ I.R.C. § 1400Z-2(d)(2)(D)(i).

⁶⁸ I.R.C. § 1400Z-2(e)(2) (“Defining persons as related to each other for purposes of the QOZ rules if such persons are described in section 267(b) or 707(b)(1), determined by substituting 20% for 50% each time it appears in such subsections.”).

⁶⁹ I.R.C. § 1400Z-2(d)(2)(D)(ii).

⁷⁰ J. Leigh Griffith, *Opportunity Zones: Finally Off and Jogging but Not Yet Running (Part II)*, 97 TAXES 15, 17, 21 (2019); I.R.S., *Opportunity Zones Frequently Asked Questions*, I.R.S. (Nov. 2, 2021), <https://www.irs.gov/credits-deductions/opportunity-zones-frequently-asked-questions>.

⁷¹ I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17.

just its tangible property) would need to be invested in QOZ Business Property.⁷² Furthermore, unlike a QOZB, a QOF measures its compliance with the 90% investment standard against all its assets (not just tangible property), including, among other things, all cash, cash equivalents and debt instruments with a term of 18 months or less (collectively, “working capital assets”) held by the QOF for longer than six months and intangibles that cannot satisfy the definitional requirements for QOZ Business Property.⁷³

Moreover, the final regulations under section 1400Z-2, effective as of January 13, 2020, as amended by correcting amendments issued on April 1, 2020,⁷⁴ provide that a QOZB that has a written plan with a reasonable written schedule in place for expenditure of its working capital assets is protected by the WCSH safe harbor from being disqualified as a QOZB for failing to hold less than 5% of the average of the aggregate unadjusted bases of the property held by the entity in “nonqualified financial property” (“NQFP”). NQFP includes debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, cash and cash equivalents, but does not include reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less and certain business accounts and notes receivable (the “5% NQFP limitation”).

Moreover, once the QOZB has satisfied the WCSH for treating working capital assets as reasonable in amount for purposes of the 5% NQFP limitation, three ancillary safe harbors apply to allow the entity to be treated as a QOZB during the applicable safe harbor period of up to 86 months (taking Notice 2021-10 into account).⁷⁵ First, even though less than 70% of an entity’s tangible property, owned or leased, is QOZ Business Property used in a trade or business of the entity, as required by section 1400Z-2(d)(3)(A)(i), the WCSH allows the entity to be treated as satisfying the 70% tangible property requirement during the WCSH period(s) that apply to the entity’s working capital assets or, if earlier, until the end of the start-up period before the entity’s trade or business commences.⁷⁶ Second, while a QOZB is required to derive 50% of its gross income from the active conduct of a trade or business in a QOZ (the “50% gross income requirement”), gross income earned from such working capital

⁷² James R. Hamill & Rebecca Abraham, *Structuring Single-Property Qualified Opportunity Fund Investments*, 97 TAXES 37, 42 (2019).

⁷³ Prop. Treas. Reg. § 1400Z-2, 84 Fed. Reg. 18,652, 18,660 (May 1, 2018).

⁷⁴ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D)(1) (as amended by 85 Fed. Reg. 19,082, 19,084 (Apr. 6, 2020)); I.R.S. Notice 2021-10, 2021-7 I.R.B. 888, 888 (Feb. 16, 2021).

⁷⁵ Deloitte U.S., *Quality Opportunity Fund investors granted relief in response to COVID-19*, DELOITTE TAX@HAND, (Jul. 2, 2020), <https://www.taxathand.com/article/14880/United-States/2020/Quality-Opportunity-Fund-investors-granted-relief-in-response-to-COVID-19>.

⁷⁶ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D)(1) (as added by T.D. 9889, 85 Fed. Reg. 19,082, 19,082 (Apr. 6, 2020) (providing correcting amendments released on April 1, 2020, that are retroactively effective as of January 13, 2020) and amended by T.D. 9889, 86 Fed. Reg. 42,716, 42,716 (Aug. 5, 2021) (providing a start-up business limitation on the deemed satisfaction of the 70% tangible property requirement, released on August 5, 2021, that applies retroactively as of January 13, 2020)). For rules applicable to start-up businesses, see *Richmond Television Corp. v. United States*, 345 F.2d 901, 905–07 (4th Cir. 1965), *vacated and remanded on other grounds*, 382 U.S. 68 (1965), and *original holding on this issue reaff’d*, 354 F.2d 410 (4th Cir.).

assets (such as interest on cash deposits and debt instruments with a term of 18 months or less) is counted toward satisfaction of the 50% gross income requirement during the WCSH period(s) covering the QOZB's working capital assets.⁷⁷ Third, for purposes of satisfying the requirement that a substantial portion (at least 40%) of a QOZB's intangible property must be used in the active conduct of a trade or business in a QOZ (the "40% intangible property use requirement"), intangible property purchased or licensed with working capital assets during the WCSH period(s) will count toward satisfaction of the 40% threshold during any period in which the entity is proceeding in a manner substantially consistent with its written working capital plan and schedule.⁷⁸

In correcting amendments, issued by the Treasury Department and IRS on April 1, 2020, a new provision was added to explain that "during the working capital safe harbor period(s) for which the [WCSH] requirements of [Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(A) through (C)] are satisfied,"⁷⁹ which require a written plan with a reasonable written schedule for spending working capital on the development of a business in a QOZ within 31 months of receipt, subject to disaster and governmental delays, "the entity satisfies the requirements of section 1400Z-2(d)(2)(D)(i) only during the working capital safe harbor period(s)."⁸⁰ Section 1400Z-2(d)(2)(D)(i) sets forth requirements for tangible property to be QOZ Business Property, but that provision is incorporated into the QOZB's tangible property requirement under section 1400Z-2(d)(3)(A)(i).⁸¹ That provision provides that to be a QOZB, a partnership or corporation must hold substantially all (at least 70%) of its tangible property, owned or lease, in QOZ Business Property "determined by substituting 'qualified opportunity zone business' for 'qualified opportunity fund' each place it appears in [section 1400Z-2(d)(2)(D)]."⁸² While not free from doubt, the Treasury Department's statement that "during the working capital safe harbor period(s), the entity satisfies the requirements of section 1400Z-2(d)(2)(D)(i)," seemed to mean that the 70% tangible property standard was suspended during the applicable WCSH periods of up to 86 months under Notice 2021-10.⁸³

The Treasury Department and IRS subsequently issued correcting amendments on August 5, 2021 (the "2021 correcting amendments") that clarify in connection with

⁷⁷ Note that this safe harbor, provided under Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(B), is relatively limited: it only applies to "gross income [that] is *derived from property that . . . [Treas. Reg. § 1.1400Z2(d)-1] (d)(3)(v) of this section treats as a reasonable amount of working capital*"; that is, cash, cash equivalents, or debt instruments with a term of 18 months or less (working capital assets) described in a written plan and a reasonable written schedule for expenditure of such assets within a period of 31 months or less. Treas. Reg. §§ 1.1400Z2(d)-1(d)(3)(iv)-(v) (emphasis added).

⁷⁸ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(C).

⁷⁹ T.D. 9889, 85 Fed. Reg. 19082, 19084 (Jan. 13, 2020).

⁸⁰ *Id.*; Treas. Reg. § 1400Z-2(d)(3)(v)(B).

⁸¹ Treas. Reg. §§ 1400Z-2(d)(2)(D)(i), (3)(A)(i).

⁸² Treas. Reg. § 1400Z-2(d)(2)(D)(i).

⁸³ T.D. 9889, 86 Fed. Reg. 42,716, 42,716 (Aug. 5, 2021).

both the 31-month and the extended 62-month WCSHs (extended by Notice 2021-10 to a maximum of 55 months and 86 months, respectively) that only start-up businesses are deemed to satisfy the 70% tangible property requirement during any period in which the business is proceeding in a manner that is substantially consistent with a written working capital plan and schedule.⁸⁴ The 2021 correcting amendments also clarify that, after the start-up period, an entity must satisfy the requirements of the 70% tangible property standard while a valid WCSH is in effect.⁸⁵ As modified, Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D)(1) provides:

For start-up businesses utilizing the working capital safe harbor, if [Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v) (establishing criteria for the WCSH, including the extension for federally-declared disasters)] treats property of an entity that would otherwise be nonqualified financial property as being a reasonable amount of working capital because of compliance with the three requirements of [Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v) (that is, having a working capital plan and schedule and spending working capital in a manner substantially consistent with that written plan and schedule)], the entity satisfies the requirements of section 1400Z-2(d)(3)(A)(i) [i.e., the requirement that a QOZB hold at least 70% of its tangible property in QOZ Business Property] only during the working capital safe harbor period(s) for which the requirements of [Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(A) through (C)] are satisfied; however, such property is not qualified opportunity zone business property for any purpose.⁸⁶

This means that such a new entity, organized for purposes of being a QOZB, but not yet “carrying on any trade or business” within the meaning of section 162 of the Code, is treated as satisfying the QOZB’s 70% tangible property standard with respect to QOZ Business Property, regardless of what tangible property it holds during the 31-month to 86-month safe harbor period.⁸⁷ Pursuant to Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D)(1), the start-up business’s 70% tangible property standard is suspended while a valid WCSH is in effect, even though the entity has not placed its assets in service of an active trade or business for federal income tax purposes and owns no tangible property that satisfies the requirements for being QOZ Business Property.⁸⁸

⁸⁴ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D) (as modified by T.D. 9889, 86 Fed. Reg. 42,716, 42,716 (Aug. 5, 2021) (providing corrections to the regulatory text) and by T.D. 9889, 86 Fed. Reg. 42,715, 42,715 (Aug. 5, 2021) (making corrections to corresponding parts of the Preamble)).

⁸⁵ *Id.*

⁸⁶ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D) (as modified by T.D. 9889, 86 Fed. Reg. 42,716, 42,716 (Aug. 5, 2021)).

⁸⁷ I.R.C. § 162; T.D. 9889, 86 Fed. Reg. 42,715, 42,715 (Aug. 5, 2021) (“In general, the 62-month working capital safe harbor under the final regulations provides that, during the maximum 62-month covered period, if property of a start-up entity that would otherwise be NQFP is treated as being a reasonable amount of working capital under the safe harbor, the start-up entity satisfies the requirements of section 1400Z-2(d)(3)(A)(i) only during the working capital safe harbor period(s) with regard to such property.”).

⁸⁸ See I.R.C. § 1400Z-2(d)(2)(D)(i) (“The term ‘qualified opportunity zone business property’ means tangible property used in a trade or business of the qualified opportunity fund [or qualified opportunity zone business] if [certain additional requirements are met].”); § 1400Z-2(d)(3)(A)(i) (defining a QOZB as an entity “in which substantially all of the tangible

Following the start-up period, the 70% tangible property standard will generally apply to the entity, even if that entity is otherwise covered by a valid WCSH plan and schedule.⁸⁹ But a second rule, also clarified by the 2021 correcting amendments, will continue to apply.⁹⁰ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D)(2) provides that for “any eligible entity,” including, but not limited to start-up businesses, that has a valid WCSH in effect, if tangible property held by that entity is expected to satisfy the requirements for being QOZ Business Property as a result of the planned expenditure of working capital under a written working capital plan and schedule, then that tangible property is treated as QOZ Business Property during the 31-month to 86-month working capital safe harbor period to which such property is subject.⁹¹ Thus, under the safe harbor applicable to any eligible business, tangible property that the business has purchased or leased, but has not placed in service, or tangible property that is in the process of being substantially improved in a manner substantially consistent with a WCSH plan and schedule may be counted toward satisfying the entity’s 70% QOZ Business Property requirement for QOZBs while the property is being constructed or improved.⁹²

Without the WCSH’s protection, a QOF (or QOZB) that invests in existing property directly may not be protected from satisfying the QOZ Business Property requirement during the entire period in which the acquired property is being substantially improved.⁹³ The section 1400Z-2 regulations provide a limited safe harbor for QOFs undertaking a substantial improvement of property previously used or placed in service in a QOZ.⁹⁴ Under this safe harbor, only a QOF that is undertaking the *substantial improvement* of *tangible* property previously used or placed in service in a QOZ is protected from satisfying the QOZ Business Property requirements for work-in-progress on that property. Moreover, this safe harbor applies only *during the 30-month substantial improvement period in which the QOF reasonably expects that the property will be substantially improved and used in its trade or business in a QOZ by the end of that 30-month period* (extended to a maximum of 42 months, taking

property owned or leased by the taxpayer is qualified opportunity zone business property (determined by substituting ‘qualified opportunity zone business’ for ‘qualified opportunity fund’ each place it appears in [I.R.C. § 1400Z-2(d)] (2)(D))”.

⁸⁹ Jessica Millett, *The Key to QOZB Compliance – The Working Capital Safe Harbor: D&S Road Map to Opportunity Zones*, 73 UNIV. S. CAL. L. SCH. INST. ON MAJOR TAX PLAN. 500, 506 (2021).

⁹⁰ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vi)(D)(2) (as added by T.D. 9889, 85 Fed. Reg. 19082, 19082 (Apr. 6, 2020) and amended by T.D. 9889, 86 Fed. Reg. 42716, 42716 (Aug. 5, 2021)).

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*; Michael Neiman, *Qualified Opportunity Zones - How Active Participation and Complementary Legislation Can Help States Develop Their Distressed Communities*, 48 CAP. U. L. REV. 457, 470–71 (2020).

⁹⁴ See Treas. Reg. § 1.1400Z2(d)-2(b)(4)(ii).

Notice 2021-10 into account).⁹⁵ That means, if the QOF expects to take longer than 30 months, as extended by Notice 2021-10, to complete the development of tangible property that is undergoing substantial improvement, the QOF's work-in-progress property will *not* be considered QOZ Business Property for purposes of satisfying the 90% investment standard during any period before or after the last 30-month substantial improvement period by the end of which the QOF expects to complete the substantial improvement and use the property in the QOF's trade or business in a QOZ.⁹⁶ Moreover, while this safe harbor for QOFs treats the QOF's work-in-progress on tangible property undergoing the substantial improvement process as QOZ Business Property during the applicable 30-month substantial improvement period immediately before the tangible property is placed in service or otherwise used in the business of the QOF, it does *not* otherwise protect the QOF from failing the 90% investment standard with respect to any other property. Thus, the QOF is not protected under this safe harbor from failing its 90% investment standard because it holds either financial property (such as cash, cash equivalents or debt instruments with a term of 18 months or less) for the purpose of completing the improvement project or intangible assets intended to be used in connection with the substantially improved property (such as trademarks, trade names or workforce-in-place).⁹⁷

QOFs that invest through QOZBs are able to utilize multiple applications of the 31-month working capital safe harbor in the context of capital-intensive projects for start-up periods of up to 86 months (taking Notice 2021-10 into account) to maintain compliance with the 90% investment standard without the limitations of the QOF's safe harbor for property undergoing substantial improvement. Consequently, most QOFs take advantage of a two-tier structure to invest through a QOZB in the development of their businesses in QOZs, including, but not limited to, the acquisition, construction, substantial improvement or leasing of QOZ Business Property for their business(es) in a QOZ.⁹⁸

The QOZ program offers three incentives for taxpayers investing in low-income communities through a self-certified QOF, which may, in turn, invest in one or more QOZ businesses, or QOZBs.⁹⁹ First, a taxpayer may defer federal income tax on gains realized before 2027, which are timely rolled over into an investment in a QOF, unless the investment is sold before then.¹⁰⁰ In addition, a step-up in basis for deferred gains reinvested in a QOF is available to a taxpayer on the fifth and seventh anniversary of the investment, which may exclude up to 15% of the originally deferred gain from taxation.¹⁰¹ Finally, after recognizing any remaining amount of the original gain on

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ See Treas. Reg. § 1.1400Z2(d)-1(d)(3)(vii)(C) (illustrating the application of the QOF's 90% investment standard after application of the working capital safe harbor).

⁹⁹ I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17.

¹⁰⁰ I.R.C. § 1400Z-2(b)(1).

¹⁰¹ §§ 1400Z-2(b)(2)(B)(iii)-(iv).

December 31, 2026, a taxpayer who holds an investment in a QOF for at least 10 years before selling it may elect to permanently exclude any additional gains realized on the sale or exchange of the investment.¹⁰² The temporary deferral election and basis increases apply to a taxpayer's gain reinvested in a QOF, while the permanent exclusion election only applies to gain on the sale or exchange of a QOF investment accrued since the taxpayer acquired the investment.¹⁰³ Taxpayers must make the temporary-deferral and permanent-exclusion elections separately because each applies to different gains accrued at different times.¹⁰⁴

The QOZ tax incentives build on incentives provided under the New Markets Tax Credit (NMTC) program and prior capital gains exclusion programs for investments in federally-designated enterprise zones, empowerment zones and renewal communities.¹⁰⁵ Unlike the NMTC program, however, there is no national limitation on the amount of gain that can be deferred or excluded under this program and unlike programs for enterprise zones, empowerment zones and renewal communities, more than 8,700 QOZs have been designated nationwide, making it Congress's broadest effort since the NMTC program to help economically distressed parts of America build businesses and create jobs.¹⁰⁶ Many of the specifics of the QOZ program were clarified

¹⁰² § 1400Z-2(c).

¹⁰³ I.R.S., INVESTMENT INCOME AND EXPENSES (INCLUDING CAPITAL GAINS AND LOSSES), PUB. NO. 550, CAT. NO. 15093R (Mar. 10, 2021), <https://www.irs.gov/pub/irs-pdf/p550.pdf>.

¹⁰⁴ *Instructions for Form 8949*, at 11 (Jan. 7, 2021), <https://www.irs.gov/pub/irs-pdf/i8949.pdf>.

¹⁰⁵ The Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. No. 116-260, Div. EE, Tit. I, Subtit. B, § 118(c), 134 Stat. 1182, 3051, retroactively restored the ability of taxpayer to elect tax-free treatment for rollover sales of qualified empowerment zone assets from December 31, 2017 to December 31, 2020. While Congress extended through 2025 the empowerment zone designation expiration date for purposes of the empowerment zone employment credit of up to \$3,000 for each qualified zone employee in an empowerment zone under section 1396(a) of Code, tax deferral will not be available under section 1397B for sales of empowerment zone assets in tax years beginning after December 31, 2020. *Compare* I.R.C. § 1397B(c) (terminating nonrecognition of gains on rollovers of qualified empowerment zone assets sold in tax years after December 31, 2020), *with* §§ 1391(d)(1)(A)(i), 1396(a), 1396(d)(1) (extending until December 31, 2025, the empowerment zone designation period for employers that employ qualified zone employees, within the meaning of section 1396(d) of the Code, to earn a 20% empowerment zone employment credit (up to \$3,000 per employee) with respect to qualified zone wages paid or incurring during the calendar year).

¹⁰⁶ The NMTC program has been extended through 2025 by Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. No. 116-260, Div. EE, Title I, Subtitle B, § 112(a), 134 Stat. 1182, 3051. For calendar years 2020 through 2025, the national limitation on the amount and allocation of qualifying equity investments under the NMTC program has been increased to \$5 billion per year. *Id.* This limitation is the amount of tax equity that may be awarded by the U.S. Treasury under section 45D(f)(1)(H) and the maximum NMTC amount is 39% of this amount or \$1.95 billion per year. *See* I.R.C. § 45D(f)(1)(H) (as amended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. No. 116-260, Div. EE, Title I, Subtitle B, §§ 112(a)–(b), 134 Stat. 1182, 3051); *see also* Community Development Financial Institutions Fund, U.S. Department of the Treasury, Allocation Availability (NOAA) Inviting Applications for the Calendar Year (CY) 2020 Allocation Round of the New Markets Tax Credit (NMTC) Program,

by the Treasury Department and IRS in regulations issued on December 20, 2019, which were published in the Federal Register on January 13, 2020, and corrected on April 1, 2020.¹⁰⁷ By that time, the public health emergency and concomitant economic turmoil caused by the spread of the COVID-19 pandemic in the United States had begun.¹⁰⁸

III. PREVIOUS RELIEF FROM DEADLINES DUE TO COVID-19

On March 13, 2020, President Trump declared a nationwide emergency pursuant to section 501(b) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121 et seq. (the “Stafford Act”) with respect to the ongoing COVID-19 pandemic.¹⁰⁹ The President’s emergency declaration instructed the Treasury Department and IRS to provide relief from tax deadlines to Americans who have been adversely affected by the COVID-19 emergency, pursuant to section 7508A(a) of the Code.¹¹⁰ Subsequently, in response to requests from chief executive officers of each jurisdiction, the President issued major disaster declarations under the authority of section 401 of the Stafford Act with respect to all 50 states, the District of Columbia, Puerto Rico, Guam, American Samoa, the Northern Mariana Islands and the U.S. Virgin Islands to assist with additional needs identified under the nationwide emergency declaration for COVID-19 (collectively, the “Major Disaster Declarations”). The Major Disaster Declarations issued in connection with the COVID-19 pandemic established that, beginning on January 20, 2020, a “federally declared disaster,” as defined in section 165(i)(5)(A) of the Code, existed in each of the 8,764 lower-income census tracts in the United States that have been designated as QOZs under section 1400Z-1 of the Code in Notice 2018-48, 2018-28 I.R.B. 9 (Jul. 9, 2018), as amplified by Notice 2019-42, 2019-29 I.R.B. 352 (Jul. 15, 2019).

On April 9, 2020, the Treasury Department and the IRS issued Notice 2020-23 to provide relief for certain time-sensitive actions due to be performed on or after April 1, 2020, and before July 15, 2020.¹¹¹ This notice provided a temporary extension until July 15, 2020 of the deadline for taxpayers to file certain tax and information returns,

85 Fed. Reg. 59,853, 59,853–54 (Sept. 23, 2020) (noting the availability of \$5 billion of NMTC allocation authority for the 2020 calendar year).

¹⁰⁷ T.D. 9889, 85 Fed. Reg. 1866 (Jan. 13, 2020) (as amended by T.D. 9889, 85 Fed. Reg. 19,082, 19,082 (Apr. 6, 2020) (effective as of Apr. 1, 2020); Dave Strausfeld, *Qualified Opportunity Zone Regs. Finalized*, J. ACCT. (Dec. 20, 2020), <https://www.journalofaccountancy.com/news/2019/dec/irs-qualified-opportunity-zone-regs-201922688.html>.

¹⁰⁸ *COVID-19 Timeline*, DAVID J. SENCER CDC MUSEUM: IN ASSOCIATION WITH THE SMITHSONIAN INSTITUTION, <https://www.cdc.gov/museum/timeline/covid19.html#> (last reviewed Jan. 5, 2022).

¹⁰⁹ Letter from President Donald J. Trump on Emergency Determination Under the Stafford Act, 2020 DAILY COMP. PRES. DOC. 1, 1 (Mar. 13, 2020).

¹¹⁰ *Id.* at 2.

¹¹¹ I.R.S. Notice 2020-23, 2020-18 I.R.B. 742 (Apr. 27, 2020), *amplifying* I.R.S. Notice 2020-20, 2020-16 I.R.B. 660 (Apr. 13, 2020); I.R.S. Notice 2020-18, 2020-15 I.R.B. 590 (Apr. 6, 2020), and *modifying* Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (July 1, 2014).

including, but not limited to: (1) eligible taxpayers' election to defer eligible capital gains on IRS Form 8949, *Sales and Other Dispositions of Capital Assets*; (2) the QOF's self-certification election on IRS Form 8996, *Qualified Opportunity Fund*; and (3) the annual report by investors in a QOF of their QOF holdings on IRS Form 8997, *Initial and Annual Statements of Qualified Opportunity Fund Investments*.¹¹² In addition, Notice 2020-23 provided relief for certain taxpayers electing to defer federal income tax on eligible capital gains by making a timely roll-over investment within 180 days in a QOF.¹¹³ Under Notice 2020-23, taxpayers had until July 15, 2020 to make a timely investment in a QOF with respect to gains for which the 180-day period would otherwise have expired between April 1, 2020 and July 14, 2020.¹¹⁴ Notice 2020-23 therefore provided a uniform July 15, 2020, QOF rollover investment date for taxpayers that recognized gains for federal income tax purposes between October 5, 2019, and January 17, 2020, or otherwise had a 180-day QOF investment period beginning between those dates under special rules set forth in the proposed and final regulations under Code section 1400Z-2 promulgated on May 1, 2019, and January 13, 2020, respectively.¹¹⁵

IV. EXPLANATION OF OPPORTUNITY ZONE EXTENSIONS AND ABATEMENTS

While the table included at the end of this Article provides a detailed summary of each form of automatic relief provided to QOFs and their investors under Notice 2021-10, as well as the beneficiaries, applicable time periods and procedural requirements to realize these benefits, the discussion below focuses on several key features of the new guidance.¹¹⁶ These include: (1) the additional extension of taxpayers' 180-day rollover period for capital gains realized, or deemed realized; (2) the 12-month extension to the reinvestment period for QOFs; and (3) the 24-month extension of the working capital safe harbor for QOZB operating businesses owned by QOFs. The following analysis indicates how the latter rule will allow funding of projects with development periods of seven years and two months if the QOZB first funded the project before June 30, 2021.¹¹⁷

A. COVID-19 Extension of 180-Day Investment Rollover Period

A taxpayer may elect to exclude from gross income certain capital gain (including, for this purpose, section 1231 gain realized from business property held for more than one year) on the actual or deemed sale or exchange of any property to an unrelated party in the tax year of the sale or exchange if the gain is reinvested in a QOF within

¹¹² I.R.S. Notice 2020-39, 2020-26 I.R.B. 984 (Feb. 24, 2020).

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ I.R.S. Notice 2020-23, 2020-18 I.R.B. 742 (Apr. 27, 2020), *amplifying* I.R.S. Notice 2020-20, 2020-16 I.R.B. 660 (Apr. 13, 2020), I.R.S. Notice 2020-18, 2020-15 I.R.B. 590 (Apr. 6, 2020), *modifying* Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (July 1, 2014).

¹¹⁶ I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021), *extending* I.R.S. Notice 2020-39, 2020-26 I.R.B. 984 (Jun. 22, 2020).

¹¹⁷ *Id.*

180 days of the sale or exchange.¹¹⁸ In general, the Income Tax Regulations (“Treas. Regs.”) under section 1400Z-2 provide that the 180-day period within which a taxpayer must make an investment in a QOF in order to defer a corresponding amount of gain begins as of the day on which the gain would be recognized for federal income tax purposes if the eligible taxpayer did not elect under section 1400Z-2(a)(1)(A) of the Code to defer recognition of that gain.¹¹⁹

Only taxpayers who elect to roll over certain capital gains realized before December 31, 2026, will be eligible to take advantage of the special treatment of gains realized both before and after the QOF investment under the QOZ provisions.¹²⁰ To be eligible for deferral, a taxpayer must realize gain characterized as a “capital” gain for federal income tax purposes, which, if not deferred, would have been recognized and subject to federal income tax before 2027, and which does not arise from a sale or exchange of property with a “related person,” within the meaning of section 1400Z-2(e)(2) of the Code, or from a straddle as defined in Code section 1092, with certain exceptions (an “eligible gain”).¹²¹ For this purpose, section 1400Z-2(e)(2) generally defines a related person as entities more than 20% owned by the same taxpayer under the constructive ownership rules in Code sections 267 and 707.

To obtain the tax benefits of an investment in a QOF, the taxpayer must reinvest some or all of its eligible gain into a QOF within a 180-day period, generally beginning on the date the gain would have been recognized for federal income tax purposes if the eligible taxpayer did not elect to defer recognition of that gain, and make an election under section 1400Z-2(a) of the Code to defer the gain invested in the QOF (the “deferred gain”).¹²² The requirement that taxpayers reinvest gain realized within a 180-day period, generally commencing on the date on which gain is realized for federal income tax purposes, is subject to several enumerated exceptions, discussed below and listed in the table, which may allow the taxpayer to start the 180-day investment period on a later date.¹²³ These include: (1) section 1231 gain realized by

¹¹⁸ I.R.S., *Instructions for Form 4797*, INTERNAL REVENUE SERV. (Sept. 15, 2021), <https://www.irs.gov/pub/irs-pdf/i4797.pdf>.

¹¹⁹ Prop. Treas. Reg. § 1400Z-2, 83 Fed. Reg. 54,279, 54,290 (Oct. 29, 2018).

¹²⁰ I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17.

¹²¹ Treas. Reg. §§ 1.1400Z2(a)-1(b)(11)(i)(A)–(C) (defining “eligible gains” for purposes of the QOZ program); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi) (restricting deferral elections with respect to straddles under section 1092).

¹²² Treas. Reg. § 1.1400Z2(a)-1(a).

¹²³ See Treas. Reg. §§ 1.1400Z2(a)-1(c)(8)–(9) (providing special 180-day periods for partners in partnerships, shareholders of S corporations, and beneficiaries of non-grantor trusts and estates); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(B) (providing special 180-day period for inclusion events that begins on the date of such inclusion event); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii)(B) (providing a special 180-day period for taxpayers that recognize gain under the installment method); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(B) (providing that the 180-day period for net capital gains over capital losses from section 1256 contracts sold during the tax year begins on the last day of that year); Treas. Reg. §§ 1.1400Z2(a)-1(b)(7)(ii)(A)–(B) (providing a special 180-day investment rule for the deferral of capital gain from a RIC or REIT capital gain dividend); Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(C) (providing a special 180-day investment period for deferral of a undistributed capital gains allocated from a RIC or REIT to

a taxpayer in 2019, (2) gain allocated to a taxpayer from a partnership, S corporation, nongrantor trust or estate (each a “passthrough entity”); (3) net capital gain from section 1256 contracts that were not part of a straddle at any time during a tax year, as well as certain identified straddles, marked to market on the last business day of the tax year; (4) gains from installment sales; (5) capital gains dividends from a real estate investment trust (REIT) or regulated investment company (RIC); and (6) undistributed capital gain dividends that a RIC or REIT shareholder is required to include in gross income.¹²⁴

The final regulations under section 1400Z-2 included several changes and clarifications regarding the 180-day investment period during which a taxpayer must make an investment in a QOF in order to defer a corresponding amount of eligible gain. First, partners in a partnership, shareholders of an S corporation, and beneficiaries of estates and non-grantor trusts (“passthrough owners”) that receive or are deemed to receive an allocable share of eligible gain realized by a partnership, S corporation, non-grantor trust or estate (“passthrough entity”), may choose between the following 180-day periods: (1) the date on which the passthrough entity’s 180-day investment period with respect to the eligible gain commences;¹²⁵ (2) the last day of the passthrough entity’s tax year in which the partner’s distributive share of the passthrough entity’s eligible gain is taken into account under section 706(a);¹²⁶ and (3) the 180-day period beginning on the due date for the passthrough entity’s tax return, without extensions, for the taxable year in which the passthrough entity realized the

its shareholders); I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17 (providing that, if a section 1231 gain was realized in 2019, the 180-day period may begin on December 31, 2019, or on the date on which the gain would have been recognized if a deferral election had not been made). *See also* Prop. Treas. Reg. § 1.1400Z2(a)-1(b)(2)(iii) (providing a 180-day period with respect to capital gain net income from section 1231 property for a taxable year that begins on the last day of the taxable year).

¹²⁴ Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(B) (providing an elective year-end commencement of the 180-day period for real estate investment trust (REIT) or regulative investment company (RIC) shareholders with respect to capital gain dividends); Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(C) (providing an elective 180-day period commencing at year-end for RIC or REIT shareholders required to include undistributed capital gains in income); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(B) (providing a year-end 180-day period for certain section 1256 gain); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii)(B) (providing an elective 180-day period commencing at year end for gain from installment sales); Treas. Reg. § 1.1400Z2(a)-1(c)(8)(iii)(B) (providing a default year-end commencement of the 180-day period for a partner’s distributive share of gain realized by a partnership); Treas. Reg. § 1.1400Z2(a)-1(c)(9)(i) (providing that the 180-day period for S corporation shareholders and beneficiaries of nongrantor trusts and estates, like that of partnerships commences at year-end, unless otherwise elected by the applicable taxpayer electing deferral); I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17 (“[I]f your 1231 gain was realized in 2019, your 180-day period may begin on December 31, 2019.”).

¹²⁵ Treas. Reg. § 1.1400Z2(a)-1(c)(8)(iii)(B)(1).

¹²⁶ Treas. Reg. § 1.1400Z2(a)-1(c)(8)(iii)(A). Under I.R.C. § 706(a), a partner must include her distributive share of partnership income “for any taxable year of the partnership ending within or with the taxable year of the partner.”

gain.¹²⁷ Because of the third option, many taxpayers that received an allocation of eligible gain realized by a partnership, S corporation, nongrantor trust or estate during 2019 may qualify for deferral with respect to QOF investments made by March 31, 2021, if such passthrough owners subsequently make a deferral election on IRS Form 8949, filed with a timely federal income tax return (including extensions) for the 2021 tax year.¹²⁸ Second, the 180-day investment period for REIT and RIC capital gain dividends generally begins on the last day of shareholder's taxable year in which the capital gain dividend would otherwise be recognized by the shareholder.¹²⁹ Third, if a shareholder must include its proportionate share of the RIC's or REIT's designated undistributed capital gain as long-term capital gain for the shareholder's tax year, the shareholder may defer the gain by making a QOF investment within a 180-day period beginning, at the taxpayer's option, at the close of the taxpayer's or the RIC or REIT's tax year.¹³⁰ Fourth, the final regulations clarify that gain from installment sales recognized under section 453 are eligible gains even if the installment sale occurred prior to December 22, 2017, and provide taxpayers with the flexibility to begin their 180-day period for deferring installment-sale gains through a QOF investment on either (i) the date each payment under the installment sale is received during the tax year, or (ii) the last day of the year the eligible gain under the installment method would be recognized.¹³¹ Fifth, net gain from section 1256 contracts during a tax year may also be deferred through a QOF investment made during a 180-day period that begins at the close of the taxpayer's tax year.¹³² Sixth, the 180-day investment period for net gain arising from certain identified straddles, mixed straddles and mixed-straddle accounts that a taxpayer is otherwise allowed to defer, begins on the later of the last day of the tax year or the date when all of the positions that are, or have been part of the straddle or disposed of or otherwise terminated, whichever is earlier.¹³³

An eligible taxpayer uses IRS Form 8949, *Sales and Other Dispositions of Capital Assets*, together with IRS Form 4797, *Sales of Business Assets*, with respect to deferred section 1231 gains (discussed below), to make this election on its timely-filed federal income tax return (including extensions) for the tax year in which the eligible gain

¹²⁷ Treas. Reg. § 1.1400Z2(a)-1(c)(8)(iii)(B)(2).

¹²⁸ For individual partners in a partnership (or other individual owners of passthrough entities) who have timely requested an extension of time to file their federal income tax return, this would permit a deferral election for 2021 investments in a QOF to be made as late as October 17, 2022. See I.R.S., FORM 4868, APPLICATION FOR AUTOMATIC EXTENSION OF TIME TO FILE U.S. INDIVIDUAL INCOME TAX RETURN 2 (2021), <https://www.irs.gov/pub/irs-pdf/f4868.pdf>.

¹²⁹ Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(A).

¹³⁰ Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(C).

¹³¹ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii)(B).

¹³² Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C)(4).

¹³³ Treas. Reg. §§ 1.1400Z2(a)-1(b)(11)(vi)(B), (C)(4).

would have been included if not deferred (the “deferral election”).¹³⁴ In addition, taxpayers that hold a QOF investment at any time during the tax year must file IRS Form 8997, *Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investment*, with a timely-filed federal income tax return (including extensions), since a failure to file this report for any given tax year will result in a rebuttable presumption that the taxpayer’s deferred gain must be included in gross income for the applicable year, which may be rebutted by the taxpayer filing the delinquent report.¹³⁵

Once invested, any income tax due on the gains is temporarily deferred until the earlier of the actual or deemed sale, exchange or disposition of the QOF investment (an “inclusion event”) or December 31, 2026, and may be permanently reduced based on a taxpayer’s holding period of its investment in a QOF.¹³⁶ If held for five years, 10% of the taxpayer’s realized gain is permanently excluded from taxable income for federal income tax purposes.¹³⁷ If the investment is held for seven years, a total of 15% of the taxpayer’s realized gain is permanently excluded (including 10% excluded after five years, plus an additional 5% on the seventh anniversary of the QOF investment).¹³⁸ Further, if the investment is held for at least 10 years and is sold or exchanged before January 1, 2048, the taxpayer may exclude from gross income post-acquisition gain from a basis step-up of the QOF investment to its fair market value (“FMV”), including inventory, at the time the QOF investment is sold, exchanged or otherwise disposed of in a pre-2048 transaction.¹³⁹

Notice 2021-10 extends the deadline for taxpayers to make a tax-advantaged investment in a QOF through March 31, 2021, to cover all eligible gains that would be recognized for federal income tax purposes if no election were made under section 1400Z-2(a)(1)(A) on or after October 5, 2019.¹⁴⁰ The following example illustrates how an individual who recognized an eligible gain from a direct sale or exchange of a

¹³⁴ Treas. Reg. § 1.1400Z2(a)-1(a)(2); *Instructions for Form 8949*, 9–10 (2019), <https://www.irs.gov/pub/irs-prior/i8949--2019.pdf>.

¹³⁵ Treas. Reg. § 1.1400Z2(a)-1(d)(2); I.R.S., FORM 8997, INITIAL AND ANNUAL STATEMENT OF QUALIFIED OPPORTUNITY FUND (QOF) INVESTMENTS, 3 (2019), <https://www.irs.gov/pub/irs-prior/f8997--2019.pdf>.

¹³⁶ I.R.C. § 1400Z-2(b)(1); For inclusion events, *see* Treas. Reg. § 1.1400z2(b)-1(c) providing general rules applicable to all tax payers); For special rules on inclusion events applicable to consolidated groups, *see* Treas. Reg. § 1.1502-14Z(b)(1)(i); Treas. Reg. § 1.1502-14Z(c)(3); Treas. Reg. § 1.1502-14Z(g)(2); Treas. Reg. § 1.1504-3(b)(2)(ii).

¹³⁷ I.R.C. § 1400Z-2(b)(2)(B)(iii).

¹³⁸ § 1400Z-2(b)(2)(B)(iv).

¹³⁹ Treas. Reg. § 1.1400Z2(c)-1(b)(3)(i). However, if the taxpayer’s interest in the QOF has declined in value, the investor will simply not elect the FMV basis under I.R.C. § 1400Z-2(c) and sell the QOF investment for a loss.

¹⁴⁰ I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Jan. 19, 2021), <https://www.irs.gov/pub/irs-drop/n-21-10.pdf>; Benjamin J. Armour, et al., *Internal Revenue Service Provides Additional COVID-19 Related Relief for Opportunity Zones Investors*, SULLIVAN & WORCESTER (Jan. 20, 2021), <https://www.sullivanlaw.com/news-Internal-Revenue-Service-Provides-Additional-COVID-19-Related-Relief-for-Opportunity-Zones-Investors.html>.

capital assets on or after October 5, 2019, and makes an investment in a QOF by March 31, 2021, may benefit from deferral of the tax on, and reduction of, that capital gain and permanent exclusion of the post-acquisition appreciation gain from an investment in a QOF held for at least 10 years.¹⁴¹

Example 1: General Rule for Extension of the 180-Day Period. On October 5, 2019, Individual A sells stock, with a tax basis of \$50,000, for \$150,000, on a public stock exchange to an unrelated person, and realizes a \$100,000 long-term capital gain. Normally, the taxpayer's 180-day period for deferral of that gain through a qualifying investment in a QOF would begin on October 5, 2019, and end on April 1, 2020, but because that period's expiration date falls between April 1, 2020 and March 30, 2021, the taxpayer has until March 31, 2021, to defer the gain by investing in a QOF. Thus, on March 31, 2021, Individual A invests \$100,000 into a QOF which uses these proceeds to acquire QOZ Property, and elects on IRS Form 8949, *Sales and Other Dispositions of Capital Assets*, filed with an amended federal income tax return for 2019 (IRS Form 1040-X, *Amended U.S. Individual Income Tax Return*),¹⁴² to defer the \$100,000 capital gain on its 2019 federal income tax return. Individual A also files IRS Form 8997, *Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments*, beginning in 2021, with a timely filed federal income tax return (including extensions) or an amended return, to report the \$100,000 tax-deferred investment in the QOF. Individual A holds its \$100,000 investment in the QOF until at least March 31, 2031, but not later than December 31, 2047, at which time Individual A's sale or exchange of this QOF investment is eligible for a second election that will allow Individual A to step-up its basis in the QOF investment to fair market value at the time of the sale or exchange and exclude from gross income any gain on the appreciation of its investment that exceeds the original \$100,000 investment. Assume at the time Individual A sells its interest in the QOF or a qualifying QOF passthrough investment, the initial investment has appreciated to \$500,000, and all that gain from the sale or exchange of the investment would have otherwise been taxed as long-term capital gain at a 20% federal income tax rate with a 3.8% "net investment income" tax (the "NIIT").¹⁴³ The tax benefits of tax deferral and reduction benefits of the QOF investment to the taxpayer are summarized below.

¹⁴¹ See I.R.S. Notice 2021-10, *supra* note 15; Armour, et al., *supra* note 140.

¹⁴² I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17 ("Can I still elect to defer tax on that gain if I have already filed my federal income tax return? Yes, but you will need to file an amended return. An individual or a married couple uses Form 1040-X for this purpose and attaches Form 8949.").

¹⁴³ See I.R.C. § 1411(a).

DEFERRAL ELECTION – LONG-TERM CAPITAL GAIN DEFERRAL AND BASIS STEP-UPS THROUGH 2026				
2019	03/31/2021	03/31/2025	12/31/2026	03/31/2029 to 12/31/2047
Defer paying 2019 tax of \$23,800 (\$100,000 x 23.8% = 20% capital gains rate + 3.8% NIIT)	\$100,000 investment in QOF made within 180-day period Zero Outside Basis	\$2,380 (10%) of tax forgiven at 5-year forgiven at 5-year holding period by virtue of \$10,000 basis step-up \$10,000 Outside Basis	Regardless of holding period must pay tax of \$21,420 on deferred gain (effectively 18% capital gain rate + 3.42% NIIT, or 21.42%) \$90,000 Increase in Outside Basis to \$100,000	

PERMANENT EXCLUSION ELECTION – GAIN EXCLUSION AND BASIS STEP-UP AFTER 10-YEAR HOLDING PERIOD				
2019	03/31/2021	03/31/2025	12/31/2026	03/31/2029 to 12/31/2047
	\$100,000 investment in QOF made within 180-days period (as extended by Notice 2021-10)	\$10,000 QOF outside basis increase (10% of \$100,000 Qualifying Investment)	\$90,000 QOF outside basis increase (from inclusion of deferred gain)	QOF investor makes FMV basis step-up election, excluding from the taxpayer's income all gains arising from such QOF investment's disposition or share of net proceeds from all sales and exchanges of non-inventory property from a QOF partnership or S corporation.
	Zero Outside Basis	\$10,000 Outside Basis	\$90,000 Increase in Outside Basis to \$100,000 Outside Basis	Outside Basis Increased to \$500,000 (FMV) immediately before Sale/ Exchange
TAX PAID BY TAXPAYER A				
None	None	None	\$21,420	None

Section 1231 gain on business assets held for more than one year, gain on installment sales and capital gains dividends and undistributed capital gains allocable to shareholders of RICs and REITs in 2019 may also be deferred through December

31, 2026, and reduced by 10% on the 5-year anniversary of the investment made in the QOF on or before March 31, 2021.

For purposes of making a qualifying investment in a QOF, a taxpayer is generally able to elect to defer the gross amount of any item of capital gain or section 1231 gain, without netting such gain against capital losses or section 1231 losses, respectively, for purposes of determining eligible gain.¹⁴⁴ The two exceptions to the “gross approach” to deferral of eligible gain are net capital gains recognized during a tax year from (a) capital gains net of capital losses on all section 1256 contracts (including regulated futures contracts, foreign currency contracts, nonequity options, dealer equity options and dealer securities futures contracts) that were not part of a straddle at any time during the taxable year and are held by the taxpayer at the end of the tax year (“qualified section 1256 contracts”), so that, under section 1256(a)(1), they are treated as sold for fair market value on the last business day of the year,¹⁴⁵ and (b) capital gains from certain identified straddles,¹⁴⁶ identified mixed straddles,¹⁴⁷ or mixed-straddle accounts,¹⁴⁸ to the extent such gains are eligible for deferral,¹⁴⁹ which must be netted against the sum of the capital losses and net ordinary loss (if any) from all of the positions that were part of that identified straddle or mixed straddle or included in such mixed-straddle account that are recognized by the end of the taxable year.¹⁵⁰

Because capital gain net income from qualified section 1256 contracts is determined at the individual or corporate investor level after netting all gains and losses on such contracts held by the taxpayer on the last day of the tax year, it makes sense that the government established a 180-day tolling period for making a QOF investment with respect to such net gain that begins at the end of the taxable year that capital gain net income was determined at the individual or corporate taxpayer level.¹⁵¹ Similarly, in the case of net capital gain during the taxable year from positions that were part of an identified straddle or mixed straddle or included in a mixed straddle

¹⁴⁴ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(i)(A) (providing that in calculating capital gain or qualified 1231 gain eligible for deferral, the gain does “[n]ot tak[e] into account any losses unless otherwise specified in the section 1400Z-2 regulation,” as in the case of net gain on section 1256 contracts).

¹⁴⁵ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C)(1).

¹⁴⁶ See I.R.C. § 1092(a)(2).

¹⁴⁷ See § 1256(d); see generally Treas. Reg. § 1.1092(b)-3T; Treas. Reg. § 1.1092(b)-6.

¹⁴⁸ See generally Treas. Reg. § 1.1092(b)-4T.

¹⁴⁹ See Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C) (providing an exception to the general rule that capital gains from straddles do not qualify as eligible gains for positions that, during a taxable year, were part of an identified straddle under section 1092(a)(2), part of an identified mixed straddle under Treas. Reg. § 1.1092(b)-3T (and, as applicable, Treas. Reg. § 1.1092(b)-6), part of an identified straddle under section 1256(d), or included in a mixed straddle account under Treas. Reg. § 1.1092(b)-4).

¹⁵⁰ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C)(iv)(2).

¹⁵¹ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(B).

account that can be deferred pursuant to the final regulations under section 1400Z-2,¹⁵² the taxpayer's 180-day investment period in which to acquire a qualifying investment in a QOF begins on the earlier of the date when all of the positions that were part of the straddle are disposed of (or otherwise terminated) or the last day of the taxable year, so that eligible gain from such identified straddles or mixed straddle accounts with a position marked to market at the end of year under section 1256(a)(1) would likewise have a 180-day tolling period beginning at year end.¹⁵³

Example 2: Deferral of Short-Term Capital Gain from Identified Mixed Straddle with Section 1256 Contract Market to Market at Year End. On January 1, 2019, an individual taxpayer ("Taxpayer") buys 100 shares of publicly traded Exchange Traded Fund A (ETF A) and acquires offsetting section 1256 contracts on the index that underlies the ETF A shares. Assume that Taxpayer holds the positions as capital assets and holds no other offsetting positions. Taxpayer makes a valid and timely identification of all 100 ETF A shares and the offsetting section 1256 contracts under Treas. Reg. § 1.1092(b)-3T. On December 31, 2019, the fair market value of the ETF A shares has increased by \$500,000, and the fair market value of the section 1256 contracts has decreased by \$400,000. On December 31, 2019, Taxpayer sells the ETF shares for a \$500,000 gain. In addition, under section 1256(a)(1), the section 1256 contracts are treated as sold for fair market value on the last business day of 2019, for a \$400,000 loss.

Pursuant to Treas. Reg. § 1.1092(b)-3T(b)(4), Taxpayer has a net short term capital gain from the identified mixed straddle of \$100,000 (\$500,000 – \$400,000), which would be taxed at 40.8% maximum tax rate (37% income tax, plus 3.8% NIIT) for a prospective tax cost of \$40,800 (40.8% of \$100,000) if the taxpayer did not elect to defer the gain under section 1400Z-2(a)(1)(A).

Under Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C), the taxpayer may generally elect to defer \$100,000 of net short term capital gain from the identified mixed straddle for 2019 by making an investment in a QOF by June 27, 2020. But Notice 2021-10 allows that short-term capital gain to be deferred from 2019 gross income if an investment in a QOF is made by March 31, 2021.¹⁵⁴ The following illustrates the tax consequences to Taxpayer of making such an election with respect to this \$100,000 in short term capital gain if a 3.8% NIIT applies and the \$100,000 investment in the

¹⁵² See Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C) (authorizing net capital gain derived from positions in an identified straddle or mixed straddle or a mixed straddle account to be deferred if, during the taxable year, all gains and losses would be recognized by the end of the of the taxable year if a deferral election had not been made and no positions in the straddle or mixed-straddle account were unrecognized as of the end of such year).

¹⁵³ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C)(4).

¹⁵⁴ See generally Treas. Reg. § 1.1400Z(2)a-1; Blake Christian, *IRS Notice 2021-10 Provides Additional Short-term Relief for Qualified Opportunity Fund Requirements*, HCVT (Jan. 22, 2021), <https://www.hcvt.com/alert-covid-19-relief-opportunity-zones>.

QOF increases to \$500,000 in value by the end of the 10-year holding period for the QOF investment.

DEFERRAL ELECTION – SHORT-TERM CAPITAL GAIN DEFERRAL AND BASIS STEP-UPS THROUGH 2026				
2019	03/31/2021	03/31/2025	12/31/2026	03/31/2029 to 12/31/2047
Defer paying 2019 tax of \$40,800 (\$100,000 x 37% = 37% ordinary income rate on short-term capital gains + 3.8% NIIT)	\$100,000 investment in QOF made within 180-day period	\$4,080 (10%) of tax forgiven at 5-year forgiven at 5-year holding period by virtue of \$10,000 basis step-up	Regardless of holding period must pay tax of \$36,720 on deferred gain (effectively 33.33% Short-term capital gain rate + 3.42% NIIT, or 36.72%)	
	Zero Outside Basis	\$10,000 Outside Basis	\$90,000 Increase in Outside Basis to \$100,000	

PERMANENT EXCLUSION ELECTION – GAIN EXCLUSION AND BASIS STEP-UP AFTER 10-YEAR HOLDING PERIOD				
2019	03/31/2021	03/31/2025	12/31/2026	03/31/2029 to 12/31/2047
	\$100,000 investment in QOF made within 180-days period (as extended by Notice 2021-10)	\$10,000 QOF outside basis increase (10% of \$100,000 Qualifying Investment)	\$90,000 QOF outside basis increase (from inclusion of deferred gain)	QOF investor makes FMV basis step-up election, excluding from the taxpayer's income all gains arising from such QOF investment's disposition or share of net proceeds from all sales and exchanges of non-inventory property from a QOF partnership or S corporation.
	Zero Outside Basis	\$10,000 Outside Basis	\$90,000 Increase in Outside Basis to \$100,000 Outside Basis	Outside Basis Increased to \$500,000 (FMV) immediately before Sale/Exchange
TAX PAID BY TAXPAYER A				
None	None	None	\$36,720	None

Section 1231 gain on business assets held for more than one year, discussed below, as well as installment sales and capital gains dividends and undistributed capital gains allocable to shareholders of RICs and REITs may also be deferred through December 31, 2026, and reduced by 10% on the 5-year anniversary of the investment made in

the QOF on or before March 31, 2021.¹⁵⁵ Pursuant to Notice 2021-10, any taxpayer that realized gain on or after October 5, 2019, received an extension of their time period for making a tax-deferred investment in a QOF from 180 days to 544 days (i.e., the period from October 5, 2019 through March 31, 2021).¹⁵⁶ Likewise, a calendar-year taxpayer that on January 1, 2019, recognized a section 1231 gain on business assets held for more than one year,¹⁵⁷ received payment on an installment sale recognized under the installment method under section 453,¹⁵⁸ received a RIC or REIT capital gain dividend,¹⁵⁹ was allocated a share of undistributed capital gains from a RIC or REIT required to be included in the taxpayer's taxable income as of that date,¹⁶⁰ or was a partner, shareholder or beneficiary of a partnership, S corporation or nongrantor trust or estate with a calendar-year tax year that recognized gain on that date,¹⁶¹ would have a total of 821 days within which to make a tax-deferred investment in a QOF.

Gain or loss from the disposition (including involuntary conversion) of depreciable or real property other than inventory used in a trade or business and held for more than one year, as well as certain livestock other than poultry, unharvested crops, timber, coal and domestic iron ore including inventory held within prescribed periods, may be treated as capital in nature, even though the property is not a capital asset.¹⁶² Section 1231 governs the character of a taxpayer's gains or losses, not otherwise characterized as ordinary income by the recapture rules of section 1245 or 1250,¹⁶³ from (i) the sale,

¹⁵⁵ I.R.C. §§ 1400Z-2(a)-(c).

¹⁵⁶ Lisa M. Starczewski & Mitchell I. Horowitz, *IRS Further Extended Opportunity Zone Timelines*, BUCHANAN INGERSOLL & ROONEY PC (Jan. 21, 2021), <https://www.bipc.com/irs-further-extends-opportunity-zone-timelines>.

¹⁵⁷ I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17.

¹⁵⁸ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii).

¹⁵⁹ Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(A).

¹⁶⁰ Treas. Reg. § 1.1400Z2(a)-1(b)(7)(ii)(C).

¹⁶¹ Treas. Reg. § 1.1400Z2(a)-1(b)(7)(iii); Treas. Reg. § 1.1400Z2(a)-1(c)(8)(iii)(B)(2) (allowing a partner's 180-day period with respect to a distributive share of eligible gain from a partnership to begin "on the due date for the partnership's tax return, without extensions, for the taxable year in which the partnership realized the gain"); Treas. Reg. § 1.1400Z2(a)-1(c)(9)(i) (providing same rule as partners in a partnership for beneficiaries of nongrantor trusts and estates and S-corporation shareholders).

¹⁶² *See* I.R.C. § 1221(a)(2); I.R.C. §§ 1231(a)(1), (a)(3)(A), (b)(2), (b)(3)(A), (b)(3)(B), (b)(4).

¹⁶³ *See* Treas. Reg. § 1.1245-6(a) (overriding section 1231 with respect to so much of the gain as is recharacterized by section 1245's recapture rules as ordinary income); Treas. Reg. § 1.1245-6(d)(1) (providing that if section 1231 gain reported on the installment method is required to be recaptured as ordinary income under section 1245(a)(1), each installment payment is deemed to consist of ordinary income under section 1245 until all such gain has been reported and only the remainder is allowed as section 1231 gain); Treas. Reg. § 1.1245-6(d)(2) (providing an example of the application of section 1245(a)(1) to each of the first seven

exchange, or involuntary conversion of depreciable, amortizable or real property (other than inventory, self-created intangibles and U.S. government publications) used in a trade or business and held for more than one year,¹⁶⁴ as well as certain timber, coal, domestic iron ore, livestock (other than poultry) and unharvested crops within prescribed holding periods,¹⁶⁵ and (ii) the involuntary conversion (but not the sale or exchange) of capital assets held for more than one year (such property, collectively, “*section 1231 property*”).¹⁶⁶ Section 1231 gains and losses on section 1231 property are aggregated by tax year, and if a net loss results, that “*net section 1231 loss*” for the year is treated as an ordinary loss, deductible against ordinary income taxed at a maximum graduated rate of 37% (39.6% for tax year before 2018).¹⁶⁷ If there is a net gain for the year, that “*net section 1231 gain*” is recognized to the extent it is not deferred and treated as long-term capital gain, taxed at a maximum capital gains rate of 20%.¹⁶⁸ When a section 1231 gain is recognized, it is first allocated to section 1245 or 1250 recapture of previous depreciation or amortization deduction, and the remaining section 1231 gain net of section 1231 losses is treated as capital gain for the tax year.¹⁶⁹

However, this final netting is subject to the application of rules under section 1231(c) governing the recapture as ordinary income rather than capital gain of net section 1231 losses deducted against ordinary income for the five most recent preceding tax years.¹⁷⁰ Under section 1231(c), if, in a given year, a taxpayer recognizes a net section 1231 gain, but has taken an ordinary deduction for a net section 1231 loss within the last five years, the prior ordinary losses deductions is “recaptured” by recharacterizing that portion of the net section 1231 gain in the current year as ordinary income rather than long-term capital gain.¹⁷¹

To illustrate the operation of section 1231 in the absence of a deferral election, suppose that an individual taxpayer primarily engaged in the business of leasing motor vehicles to the general public, who does not maintain facilities for the retail sale of motor vehicles to the general public, recognizes a loss of \$10,000 on a sale by the auto rental business of a car used in its rental fleet for more than one year at the end of 2019 and a gain of \$10,000 on a sale of a formerly leased truck used in the fleet for several

installments reported under the installment method before section 1231 gain is recognized in the final installments).

¹⁶⁴ I.R.C. §§ 1231(a)(3)(A)(i), (a)(3)(A)(ii)(I), (b)(1); Treas. Reg. § 1.1231-1(b)(1); Treas. Reg. § 1.1231-2(a)(1).

¹⁶⁵ I.R.C. § 1231(a)(3)(A)(i); *see generally* I.R.C. §§ 1231(a)(3)(A)(ii)(II), (a)(3)(A)(ii)(I), (b)(1)–(4); I.R.C. §§ 631(a)–(c); Treas. Reg. § 1.1231-1(b)(1); Treas. Reg. § 1.1231-2(a)(1).

¹⁶⁶ I.R.C. § 1231(a)(3)(A)(ii)(II); Treas. Reg. § 1.1231-1(b)(2).

¹⁶⁷ *See* I.R.C. §§ 1231(a)(2), 1(j)(2).

¹⁶⁸ § 1231(a)(1); § 1(h)(1)(D).

¹⁶⁹ *See* Treas. Reg. § 1.1245-6(a); Treas. Reg. § 1.1250(b)(i).

¹⁷⁰ I.R.C. §§ 1231(c)(1)–(2).

¹⁷¹ I.R.C. § 1231(c).

years at the start of 2020, which is not otherwise recharacterized as ordinary income by the depreciation recapture rules of section 1245 or 1250.¹⁷² The taxpayer recognizes no other gain or loss in either year, so that the taxpayer's \$10,000 loss in 2019 is an ordinary loss, which may reduce income subject to U.S. federal income tax at graduated rates of up to 37%, plus the tax on net investment income of 3.8%, for a tax benefit of \$4,080 (40.8% of \$10,000).¹⁷³ Although the taxpayer's \$10,000 net section 1231 gain in 2020 would normally be taxed at long-term capital gains rates of up to 20%, plus the 3.8% NIIT, for a tax cost of only \$2,380 (23.8% of \$10,000), section 1231(c) prevents the taxpayer from timing sales to recognize section 1231 (ordinary) loss in one year followed by section 1231 (capital) gain in any of the five succeeding years.¹⁷⁴ Therefore, these rules will characterize the taxpayer's \$10,000 gain recognized in 2020 as ordinary income rather than capital gain so that over the two years, the taxpayer recognizes a \$10,000 ordinary loss and a \$10,000 ordinary gain, generating a \$4,080 cost in 2020 to offset the \$4,080 benefit in 2019 for a net zero tax benefit—the same result that would have obtained if the truck and car had both been sold by the taxpayer in the same year.

Section 1231 is an important provision for most business enterprises, including corporations and sole proprietorships, because it provides for the preferential treatment of virtually all noninventory property of a business that is sold, exchanged or compulsorily or involuntarily converted¹⁷⁵ by casualty, theft or condemnation after being held for more than one year,¹⁷⁶ as well as certain farm assets, such as livestock

¹⁷² Rev. Rul. 75-544, 1975-2 CB 343 (providing that section 1231 is generally applicable, subject to depreciation recapture, to taxpayers primarily engaged in leasing of motor vehicles, who sell their used vehicles at prices that do not contemplate dealer's profit to dealers, wholesalers, or jobbers, and who do not have showrooms, used car lots, or sales forces for retail sale of motor vehicles).

¹⁷³ Each year, the 3.8% NIIT under I.R.C. § 1411(a) applies to the lesser of (1) net investment income, or (2) the excess of adjusted gross income over a "threshold amount." I.R.C. § 1411(b) defines this threshold amount as \$250,000 for married couples filing jointly and \$200,000 for single taxpayers. "Net investment income" includes gain from the disposition of property, interest, dividends, rental and royalty income, annuities from businesses that trade financial instruments or commodities, and income from businesses that are treated as passive activities under section 469. *See* I.R.C. § 1411(c).

¹⁷⁴ § 1231(c).

¹⁷⁵ Treas. Reg. § 1.1231-2(b)(1) (including, within the scope of section 1231 property, animals (other than poultry) held by large farms that sell their livestock to customers); *see generally* I.R.C. § 1231.

¹⁷⁶ § 1231(a)(4).

(other than poultry) and unharvested crops, and taxpayers in the timber,¹⁷⁷ coal,¹⁷⁸ and domestic iron ore industries,¹⁷⁹ that may be held for sale to customers or be properly includible in inventory of the applicable farming, timber cutting or mining business.¹⁸⁰ Examples of the types of transactions to which section 1231 apply include (i) a professional sports team making a trade of players or draft picks to another team in exchange for cash and players or draft picks,¹⁸¹ (ii) sales of land, buildings, easements and leasehold interests used by the business, (iii) sales of automobiles, trucks, airplanes and boats used to transport goods or leased to customers in a motor vehicle leasing business, (iv) the sale of a patent, copyright, formula, process, design, or pattern acquired for cash from the intangible's creator, (v) the sale of a franchise, trademark, trade name, or goodwill or going concern value, to the extent such intangible assets satisfy the anti-churning rule and are amortizable under section 197,¹⁸² and (vi) the sale of certain inventory by large animal and timber farms and coal and domestic iron ore mining companies.¹⁸³

Under the proposed QOZ regulations, only a taxpayer's "capital gain net income" arising from dispositions of section 1231 property for a tax year could be deferred by

¹⁷⁷ See § 1231(b); § 1231(b)(2) (referencing cut timber treated as sold or exchanged under section 631(a) and the disposal of timber with a retained economic interest under section 631(a) and (b)); Treas. Reg. § 1.631-2(a)(2) (treating timber deemed sold under a cutting contract treated as "property used in [a] trade or business" under section 1231(b)(2), even though it is held primarily for sale to customers or is properly includible in inventory of the business); Treas. Reg. § 1.631-1(d)(4) (including, within section 1231(b)(3)'s definition of "property used in [a] trade or business" certain timber disposed of even though it is properly includible in inventory or held for sale to customers); see also I.R.C. §§ 631(a)–(b).

¹⁷⁸ See § 1231(a)(3)(A)(i); § 1231(b)(2) (referencing the disposal of coal with a retained economic interest for which an election is made under section 631(c) for sale-or-exchange treatment).

¹⁷⁹ See I.R.C. §§ 1231(a)(3)(A)(i), (b)(2); see also § 631(c) (allowing for election to treat the date of such payment as the date of disposal).

¹⁸⁰ See § 1231(b) (defining "property used in the trade or business," to which section 1231 applies, as depreciable or real property used in the trade or business, subject to enumerated exceptions for inventory, certain intangibles held by their creators and certain other persons described in section 1221(a)(3), and government publications held by persons described in section 1221(b)(1)); section 1231(b)(2) (including timber, coal, and iron ore with respect to section 631).

¹⁸¹ Rev. Proc. 2019-18, 2019-18 I.R.B. 1077 (Apr. 11, 2019). The gain or loss is subject to the rules in § 1231 and § 1245.

¹⁸² I.R.C. § 197(f)(9).

¹⁸³ § 1231(b)(2) (reference to timber, coal, and domestic mining under sections 631(a)–(c)); I.R.C. § 1231(b)(4) (including within section 1231 property unharvested crops); Treas. Reg. § 1.1231-2(a)(1); Treas. Reg. § 1.1231-2(a)(2) (providing for holding periods of cattle, horses, and other livestock); Treas. Reg. § 1.1231-1(c)(5).

making a timely investment in a QOF.¹⁸⁴ This capital gain net income amount required the taxpayer to take into account all section 1231 gains and section 1231 losses for a taxable year (including applicable carryovers) with respect to all of the taxpayer's section 1231 property, and to the extent section 1231 gains exceed section 1231 losses, the taxpayer was eligible to defer this capital gain net income amount.¹⁸⁵ Because taxpayer's section 1231 gains had to be netted against section 1231 loss for the year to determine the amount of gain eligible for deferral, the proposed regulations established a 180-day tolling period for investing capital gain net income from the sale or exchange of section 1231 property into a QOF that begins on the last day of the taxpayer's taxable year.¹⁸⁶

In a taxpayer favorable move, the Treasury Department and IRS provided final regulations under section 1400Z-2 on December 20, 2019, that allow electing taxpayers to defer through a QOF investment the *gross* amount of section 1231 gain, computed without regard to section 1231 losses, from a pre-2027 sale or exchange of property to or with an unrelated person, that is not otherwise characterized as ordinary income by the depreciation recapture rules of section 1245 or 1250.¹⁸⁷ Under this "gross approach" to the deferral and potential reduction of section 1231 gains reinvested in a QOF, adopted by the final regulations, a taxpayer that realizes any gross amount of section 1231 gain on any sale, exchange or involuntary conversion of section 1231 property may defer the full amount of section 1231 gain by investing the amount of the gain in a QOF within 180 days of the sale or exchange, without taking section 1231 losses on any other transaction into account, meaning that gross section 1231 gains can be deferred by taxpayers investing into a QOF, and are not first required to be netted against section 1231 losses for the year.¹⁸⁸ Because eligible gains include the gross amount of eligible section 1231 gains unreduced by section 1231 losses, it is not necessary for an investor to wait until the end of the year to determine whether any eligible section 1231 gains are eligible gains.¹⁸⁹ Therefore, under the final

¹⁸⁴ Prop. Treas. Reg. §§ 1.1400Z2(a)-1(b)(2)(iii)–(iv), 85 Fed. Reg. 19,082, 19,083 (Jan. 13, 2020).

¹⁸⁵ Conversely, no deferral is allowed with respect to section 1231 gains if section 1231 losses equal or exceed gains for the tax year. *See* Prop. Treas. Reg. § 1.1400Z2(a)-1(b)(2)(iii), 85 Fed. Reg. 19,082 (Jan. 13, 2020); *see also* Prop. Treas. Reg. § 1.1400Z2(a)-1(b)(2)(iv), 85 Fed. Reg. 19,082, 19,083 (Jan. 13, 2020).

¹⁸⁶ Prop. Treas. Reg. § 1.1400Z2(a)-1(b)(2)(iii), 85 Fed. Reg. 19,082, 19,083 (Jan. 13, 2020).

¹⁸⁷ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(i)(A); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iii)(A); Treas. Reg. § 1.1400Z2(a)-1(c)(1)(ii); I.R.S. Notice 2021-10, 2021-7 I.R.B. 890 (Feb. 16, 2021).

¹⁸⁸ *See* Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iii)(B) (providing that the general 180-day period applicable for other types of capital gain applies to qualified 1231 gain eligible for deferral under section 1400Z-2(a)(1)(A) of the Code and the section 1400Z-2 regulations); Treas. Reg. § 1.1400Z2(a)-1(b)(7)(i) (providing that the 180-day investment period generally begins on the date on which a taxpayer would otherwise recognize gain for federal income tax purposes if no deferral election had been made).

¹⁸⁹ Alan M. Blecher, *Isolating Section 1231 Gains for Opportunity Zone Investing: A Taxpayer-Friendly Option*, MARKS PANETH LLP (Apr. 27, 2021),

regulations, the 180-day investment period for section 1231 gains begins on the date of sale, and not the last day of the taxable year.¹⁹⁰

Although the final regulations adopted a 180-day period for section 1231 gains, which now generally begins on the date of the sale or exchange of section 1231 property, and not the last day of the year, that rule in the final regulations, which were not released until December 20, 2019, whipsawed some prospective QOF investors who were relying on the May 2019 proposed regulations' end-of-year commencement of the 180-day period for net section 1231 gains. Because the final regulations under section 1400Z-2 were released so close to the end of 2019, many taxpayers with section 1231 gain realized on transactions early in 2019 were apparently excluded from benefitting from the final regulations' gross approach to section 1231 gains, since their 180-day investment periods had already expired by the time of the final regulations' release in December 2019.

It was not until July 4, 2020, when the IRS updated its list of Opportunity Zones Frequently Asked Questions,¹⁹¹ in conjunction with the issuance of Notice 2020-39, that the IRS provided favorable guidance that allowed investors with gross section 1231 gains realized at any time in 2019 to treat December 31, 2019, as the first day of their 180-day investment period for purposes of making a QOF investment.¹⁹² As a result, investors that waited until the last day of 2019 to make their investment in a QOF were allowed to make those investments at any time on or before June 27, 2020, which Notice 2021-10 extended through March 31, 2021.

This favorable treatment of section 1231 gains may allow certain taxpayers with section 1231 gains and losses to realize a permanent tax rate arbitrage of 17% by deferring section 1231 gains in a given year, so that net section 1231 losses in 2019 or 2020 are treated as ordinary deductions, generating a maximum benefit of 40.8% by offsetting income that would otherwise be taxed at a maximum graduated income tax rate of 37%, plus the NIIT of 3.8%, while allowing the deferred section 1231 gain recognized in 2026 to be treated as long-term capital gains taxed at a maximum rate of 23.8%, including the 20% maximum capital gains rate and 3.8% NIIT.¹⁹³ The following example illustrates the benefits of deferring a gross section 1231 gain from

<https://www.markspaneth.com/insights/industry/industry/isolating-section-1231-gains-opportunity-zone-investing-taxpayer-option>.

¹⁹⁰ *Id.*

¹⁹¹ *IRS Provides answers about Coronavirus Related Tax Relief for Qualified Opportunity Funds and Investors*, IRS (June 2, 2020), <https://www.irs.gov/newsroom/irs-provides-answers-about-coronavirus-related-tax-relief-for-qualified-opportunity-funds-and-investors>; I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17.

¹⁹² I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17 (“Can I defer 1231 gain for a taxable year under the QOF Rule? . . . If your 1231 gain was realized in 2019, your 180-day period may begin on December 31, 2019.”).

¹⁹³ Blake Christian & Joseph B. Darby III, *O-Zone Alchemy: Turning Net 1231 Gains Into Gross 1231 Gains (and Losses)*, BLOOMBERG TAX (March 4, 2020, 4:00AM), <https://news.bloombergtax.com/daily-tax-report/o-zone-alchemy-turning-net-1231-gains-into-gross-1231-gains-and-losses>; *How are Capital Gains Taxed?*, TAX POL'Y CTR. (May 2020), <https://www.taxpolicycenter.org/briefing-book/how-are-capital-gains-taxed>.

2019 or 2020 through an investment in a QOF made available under the dual relief provided by the IRS in FAQs on opportunity zones and Notice 2021-10.¹⁹⁴

Example 3: Deferral of Gross Section 1231 Gain. In 2019, Individual A sold two buildings to an unrelated person that had been used in her trade or business and held for more than one year and had no other section 1231 gains or losses. The first sale of section 1231 property occurred on January 1, 2019 and generated a section 1231 gain of \$100,000. Individual A recognized a \$100,000 loss on the second sale of section 1231 property on December 31, 2019. Thus, Individual A would have neither a net section 1231 gain nor a net section 1231 loss recognized in 2019 in the absence of a deferral election under section 1400Z-2(a), with the section 1231 loss entirely absorbed by the section 1231 gain and the taxpayer realizing no net tax benefit in 2019 from the offsetting gains and losses. Although no deferral election could be made by Individual A through a QOF investment under the proposed regulation, since there was not a net section 1231 gain in 2019,¹⁹⁵ or within the generally applicable 180-day investment period under the final regulations beginning on the date of the taxpayer's sale on January 1, 2019,¹⁹⁶ Individual A can elect under the relief provided by the IRS in the QOZ FAQs to begin her 180-day period for investing that \$100,000 of section 1231 gain realized in January 2019 on December 31, 2019, so that Notice 2021-10 would extend the investment period for the gain through March 31, 2021. If the taxpayer elects to defer the \$100,000 in gross section 1231 gain from 2019 by making an investment in a QOF by March 31, 2021, then, in the absence of any other section 1231 gains or losses, the taxpayer's section 1231 losses would exceed section 1231 gains for 2019 by \$100,000, and the net loss in 2019 would be recognized as an ordinary loss deduction with a tax benefit of \$40,800, assuming an ordinary income tax rate of 37%, plus a 3.8% NIIT, for the income offset by the deduction.¹⁹⁷ Assuming the taxpayer holds the QOF investment until December 31, 2026, and does not recognize any net section 1231 losses in 2021 through 2025 that are required to be recaptured as ordinary income, 90% of the taxpayer's deferred gross section 1231 gain (\$90,000) from 2019 would be taxed as long-term capital gain in 2026 at a 20% federal income tax rate with a 3.8% NIIT, for a tax cost of \$21,420. The taxpayer's combined front-end tax benefit from the QOF investment is \$19,380 (\$40,800 tax benefit in 2019, less \$21,420 tax cost in 2026), compared to zero dollars of net tax benefit without a deferral election. If, as

¹⁹⁴ I.R.S., *Opportunity Zones Frequently Asked Questions*, *supra* note 17 (“Can I defer 1231 gain for a taxable year under the QOF Rule? . . . If your 1231 gain was realized in 2019, your 180-day period may begin on December 31, 2019.”).

¹⁹⁵ Prop. Treas. Reg. § 1.1400Z2(a)-1(b)(2)(iii), 85 Fed. Reg. 19082 (Jan. 13, 2020).

¹⁹⁶ This 180-day period would begin on January 1, 2019, and end on June 29, 2019. *See* Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iii)(B).

¹⁹⁷ *Questions and Answers on the Net Investment Income Tax*, INTERNAL REVENUE SERV. (Nov. 23, 2021), <https://www.irs.gov/newsroom/questions-and-answers-on-the-net-investment-income-tax>; I.R.C. § 1(j)(2); *see* § 1441(c).

in the foregoing examples, the taxpayer held its investment for at least 10 years and sold it for \$500,000, the tax benefits under section 1400Z-2 would be as follows:

DEFERRAL ELECTION – SECTION 1231 GAIN DEFERRAL AND BASIS STEP-UPS THROUGH 2026				
2019	03/31/2021	03/31/2025	12/31/2026	03/31/2029 to 12/31/2047
Defer paying 2019 tax of \$40,800 (\$100,000 x 37% = 37% ordinary income rate on short-term capital gains + 3.8% NIIT)	\$100,000 investment in QOF made within 180-day period	\$4,080 (10%) of tax forgiven at 5-year forgiven at 5-year holding period by virtue of \$10,000 basis step-up	Pay tax of \$21,420 on deferred gain (effectively 18% long-term capital gain rate + 3.42% NIIT, or 21.42%)	
	Zero Outside Basis	\$10,000 Outside Basis	\$90,000 Increase in Outside Basis to \$100,000	

PERMANENT EXCLUSION ELECTION – GAIN EXCLUSION AND BASIS STEP-UP AFTER 10-YEAR HOLDING PERIOD				
2019	03/31/2021	03/31/2025	12/31/2026	03/31/2029 to 12/31/2047
	\$100,000 investment in QOF made within 180-days period (as extended by Notice 2021-10)	\$10,000 QOF outside basis increase (10% of \$100,000 Qualifying Investment)	\$90,000 QOF outside basis increase (from inclusion of deferred gain)	QOF investor makes FMV basis step-up election, excluding from the taxpayer's income all gains arising from such QOF investment's disposition or share of net proceeds from all sales and exchanges of non-inventory property from a QOF partnership or S corporation.
	Zero Outside Basis	\$10,000 Outside Basis	\$90,000 Increase in Outside Basis to \$100,000 Outside Basis	Outside Basis Increased to \$500,000 (FMV) immediately before Sale/Exchange
TAX PAID BY TAXPAYER A				
None	None	None	\$21,420	None

Even taxpayers in an overall net operating loss (“NOL”) position in 2019 or 2020 may take advantage of the extended 180-day deferral period under Notice 2021-10 to defer and potentially reduce eligible gain realized in those years, which may create potential NOL refund opportunities that can be carried back five years under section 2303(b) of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

Under the CARES Act, net operating loss deductions arising in 2018, 2019 or 2020 are not subject to an 80% limitation, which applies for tax years beginning on or after January 1, 2021.¹⁹⁸ Thus, the amount allowed as a net operating loss deduction for applicable tax years is the aggregate of the net operating loss carryovers to such years, plus the net operating loss carrybacks to such years.¹⁹⁹ When the taxpayer's deferral of eligible section 1231 gain in 2019 or 2020 creates an NOL that is carried back to an earlier year, the effect of the deduction is to reduce or eliminate tax liability in the carryback year, resulting in an overpayment of tax.²⁰⁰ To claim a refund or credit with respect to the overpayment, a taxpayer may, within the applicable period of limitations, file an amended tax return or an application for a tentative carryback adjustment to claim the credit or refund, with an election to defer the gain on IRS Form 8949 included as an attachment.²⁰¹

Because eligible gain includes the gross amount of section 1231 gain, as defined by section 1231(a)(3)(A), unreduced by section 1231 losses for the taxable year, the preferential treatment of section 1231 gains and losses may provide certain taxpayers the opportunity to reduce ordinary income by deferring gross amounts of section 1231 gain in 2019 or 2020, which, if any net section 1231 loss resulted, would reduce or eliminate tax liability in those years, or be carried back five years to reduce section 1231 gains recognized in earlier years.²⁰² This could eliminate net section 1231 gains during the five-year carryback period that section 1231(c) otherwise required to be characterized as ordinary income to the extent of net unrecognized section 1231 losses realized within five years before the taxpayer realized such gain.²⁰³ For taxpayers planning to hold their QOF interest for at least five years until December 31, 2026, when section 1231 gains from 2019 or 2020 would eventually be taken into income, the deferral of the gains beyond the five-year recapture period under section 1231(c) offers the benefit of a 17% permanent tax rate arbitrage between the ordinary loss deductions (a maximum 37% tax benefit) created by eliminating section 1231 gains in 2019 or 2020 that will be long-term capital gain rather than ordinary income when recognized on December 31, 2026 (taxed at a maximum rate of 20%).²⁰⁴ The benefits

¹⁹⁸ Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, 134 Stat. 281.

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Instructions for Form 8949, supra* note 134.

²⁰² § 1231(a)(3)(A); *see generally* Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, 134 Stat. 281.

²⁰³ Tony Nitti, *IRS Publishes Final Opportunity Zone Regulations: Putting It All Together*, FORBES (Dec. 23, 2019, 9:11 AM), <https://www.forbes.com/sites/anthonymitti/2019/12/23/irs-publishes-final-opportunity-zone-regulations-putting-it-all-together/?sh=352801d82551>; *see* § 1231(c).

²⁰⁴ *See* Blake Christian & Joseph B. Darby III, *O-Zone Alchemy: Turning Net 1231 Gains Into Gross 1231 Gains (and Losses)*, BLOOMBERG TAX (Mar. 4, 2021, 4:00 AM), <https://news.bloombergtax.com/daily-tax-report/o-zone-alchemy-turning-net-1231-gains-into-gross-1231-gains-and-losses>.

of this strategy in the context of section 1231 gain are illustrated in the following examples.

Example 4: Deferral of Section 1231 Gain with Five-Year Carryback.

Assume that Individual A is U.S. citizen who is primarily engaged in the business of manufacturing retail clothing, that she had sufficient income in 2013 through 2018 to utilize all deductions claimed in those years and that for each tax year since 2013, she was subject to (A) income tax on gains at either (1) the maximum individual tax rate on ordinary income of 39.6% before 2018 or 37% thereafter, or (2) the maximum preferential rate on long-term capital gains of 20%, (B) plus the 3.8% rate imposed on net investment income (including gain on sales of property), for a combined tax rate on gains characterized as ordinary income of 43.4% before 2018 and 40.8% thereafter and a combined tax rate on capital gains of 23.8% in all tax years. Before January 1, 2012, Individual A acquired nine buildings that were placed in service after 1986 in connection with a manufacturing business she operated as sole proprietor and took straight-line depreciation deductions on the buildings until they were sold after being held for more than one year between 2013 and 2020, generating the only section 1231 gains and losses for those years.

Individual A sold one of the nine buildings in 2013 for a loss of \$30,000, resulting in a net section 1231 loss taken as a deduction against ordinary income taxed at a combined rate of 43.4% (39.6%, plus a 3.8% NIIT), generating a total tax benefit of \$13,020. A then sold one building each in 2014 and 2015 for gains of \$5,000 and \$25,000, respectively, causing all \$30,000 of the prior ordinary loss deduction claimed in 2013 to be recaptured under section 1231(c) by characterizing each of the gains recognized in those years as ordinary income rather than capital gain. The taxpayer's total tax cost from section 1231(c) recapture during 2014 and 2015 is \$13,020, including a cost of \$2,170 in 2014 (43.4% of \$5,000) and \$10,850 in 2015 (43.8% of \$25,000).

In 2016, 2017 and 2018, Individual A recognized net section 1231 losses of \$5,000, \$4,000 and \$1,000, respectively, generating tax savings of (i) \$2,380 in 2016 (43.4%, of \$5,000), (ii) \$2,170 in 2017 (43.4% of \$4,000), and (iii) \$408 in 2018 (37%, plus 3.8% NIIT, or 40.8%, of \$1,000). Therefore, Individual A had net unrecaptured section 1231 losses, that, under section 1231(a)(2), were deducted as ordinary losses against ordinary income, of \$5,000 in 2016, \$4,000 in 2017, and \$1,000 in 2018 for a total of \$10,000 in ordinary losses recognized under section 1231 in the five most recent tax years before 2019.

In 2019, because Individual A's section 1231 gain of \$10,000 on one building exceeded Individual A's section 1231 loss of \$5,000 on a second building sold during that year, Individual A had a net section 1231 gain of \$5,000 that is treated as ordinary income rather than capital gain under section 1231(c) to the extent thereof to recapture \$5,000 of the \$10,000 in ordinary loss

deductions in the last five years of section 1231 netting.²⁰⁵ Individual A also had a \$30,000 gain and a \$25,000 loss on the sale of the final two buildings in 2020, resulting in a net section 1231 gain of \$5,000, which is characterized as ordinary income to recapture the remaining ordinary loss deductions claimed within the last five years before 2020 of \$4,000 and \$1,000 taken in 2017 and 2018, respectively. During 2019 and 2020, the taxpayer's total tax cost is \$4,080 from the recognition of \$10,000 in ordinary income recaptured under section 1231(c).

As indicated in the first table below, in the absence of a deferral election, the taxpayer's total tax benefit is just \$234 from the eight years of section 1231 netting from 2013 through 2020, attributable to the rate differential of 2.6% between the 39.6% individual income tax rate for the income offset by \$9,000 in 2016–2017 ordinary loss deductions and the 37% income tax rate for the \$9,000 in ordinary income recaptured under section 1231(c) in 2020.

But if the taxpayer timely invested \$40,000 in a QOF by March 31, 2021, she can avoid all \$40,000 of ordinary income recapture by deferring the section 1231 gains of \$10,000 and \$30,000 in 2019 and 2020, respectively. This would leave only net section 1231 losses of \$5,000 in 2019 and \$25,000 in 2020, which are ordinary losses recognized after 2017 and before 2021 that can be carried back five years to offset the \$5,000 and \$25,000 of ordinary income recognized in 2014 and 2015. 90% of the \$40,000 in deferred gain (\$36,000) will be recognized in 2026 as long-term capital gains, at a total tax cost for the deferred gain of \$8,568 (23.8% of \$36,000), assuming no other net section 1231 losses were recognized after 2020.

As a result, the taxpayer's net tax benefit from section 1231 netting from 2013 through 2026, as a result of the deferral election, is \$8,766, or \$8,532 (3,746%) more than the \$234 net benefit recognized in the base case without a deferral election.

The following two tables sets forth information from Individual A's 14 years of section 1231 netting from 2013 through 2026. The first sets forth the tax consequences of section 1231(c) recapture in the absence of a deferral election (with a \$234 net benefit), and the second shows the front-end benefits of deferring the \$40,000 in gross section 1231 gains recognized in 2019 and 2020.

²⁰⁵ Note that section 1231(c) recaptures ordinary loss deductions taken within the last five years before a taxpayer recognizes a net section 1231 gain by recharacterizing some or all of that net gain as ordinary income rather than capital gain, which is subject to federal income tax at graduated rates in effect in that latter year. For tax years 2018 through 2025, Congress temporarily cut the maximum individual income tax rate from 39.6% to 37%, so that net section 1231 losses deductible against ordinary income under section 165 in tax years before 2018 would have offset income in an earlier year at a higher rate of tax, that the ordinary gain that recaptures it in a tax year after 2017 and before 2026. TAX FOUND., PRELIMINARY DETAILS AND ANALYSIS OF THE TAX CUTS AND JOBS ACT (2017), <https://files.taxfoundation.org/20171220113959/TaxFoundation-SR241-TCJA-3.pdf>; *see* I.R.C. § 1231(c)(1); §§ 1(j)(1)–(2).

PRE-DEFERRAL COST OF SECTION 1231(C) RECAPTURE FROM 2013 TO 2020 – No DEFERRAL ELECTION OR FIVE-YEAR CARRYBACK ²⁰⁶										
	2013	2014	2015	2016	2017	2018	2019	2020	2026 (No Deferral)	Total
Unrecaptured Loss Remaining (5-Year Look-back) =	(\$0)	(\$30,000)	(\$25,000)	(\$0)	(\$5,000)	(\$9,000)	(\$10,000)	(\$5,000)	(\$0)	
Net Section 1231 Gain (Loss)	(\$30,000)	\$5,000	\$25,000	(\$5,000)	(\$4,000)	(\$1,000)	\$5,000	\$5,000	\$0	(\$0)
Section 1231 Gain		\$5,000	\$25,000				\$10,000	\$30,000	\$0	\$70,000
Section 1231 (Loss)	(\$30,000)	-	-	(\$5,000)	(\$4,000)	(\$1,000)	(\$5,000)	(\$25,000)	\$0	(\$70,000)
Character										

²⁰⁶ For tax years beginning before January 1, 2018, the maximum tax cost of ordinary income, and the maximum tax benefit of ordinary losses that offset ordinary income, is 43.4% based on a maximum ordinary income tax rate of 39.6%, plus a net investment income tax (“NIIT”) of 3.8% on gain from the sale of property, and, for tax years beginning in 2018 or later, the maximum tax cost and benefit of ordinary income and loss, respectively, is 40.8% based on a 37% top individual income tax rate, plus 3.8% NIIT. For all years, the maximum tax cost of long-term capital gain is 23.8%, based on a maximum long-term capital gains tax rate of 20%, plus 3.8% NIIT. Phillip R. Hirschfeld, *Life Savers for Adverse Tax Reform*, A.B.A. PROB. & PROP. MAG., Nov.–Dec. 2021, at 11, 12; GARRETT WATSON ET AL., DETAILS AND ANALYSIS OF TAX PROPOSALS IN PRESIDENT BIDEN’S AMERICAN FAMILIES PLAN (2021), <https://files.taxfoundation.org/20210513123909/Details-and-Analysis-of-Tax-Proposals-in-President-Biden%E2%80%99s-American-Families-Plan.pdf>.

PRE-DEFERRAL COST OF SECTION 1231(C) RECAPTURE FROM 2013 TO 2020 – No DEFERRAL ELECTION OR FIVE-YEAR CARRYBACK ²⁰⁶										
Ordinary Loss (Current Year)	(\$30,000)			(\$5,000)	(\$4,000)	(\$1,000)				(\$40,000)
Ordinary Gain (Recapture of Prior Ordinary Loss)		\$5,000	\$25,000				\$5,000	\$5,000		\$40,000
x 43.4% (Before 2018)	(\$13,020)	\$2,170	\$10,890	(\$2,170)	(\$1,736)	(\$408)	\$2,040	\$2,040	\$0	(\$234)
x 40.8% (After 2017)										
Long-Term Capital Gain (LTC-G)									\$0	
x 23.8% Rate =									\$0	
Tax Benefit (Cost)	\$13,020	(\$2,170)	(\$10,890)	\$2,170	\$1,736	\$408	(\$2,040)	(\$2,040)	\$0	(\$234)

FRONT-END TAX BENEFITS FROM DEFERRAL ELECTION, PLUS FIVE-YEAR CARRYBACK – ELIMINATION OF SECTION 1231(C) RECAPTURE – SECTION 1231 GAINS										
	2013	2014	2015	2016	2017	2018	2019	2020	2026	Total
Unrecaptured Loss Remaining (5-Year Look-back) =	(\$0)	(\$30,000)	(\$25,000)	(\$0)	(\$5,000)	(\$9,000)	(\$10,000)	(\$15,000)	(\$0)	(90% of \$40,000 Deferred Gain from 2019 – 2020)
Net Section 1231 Gain (Loss)	(\$30,000)	\$5,000	\$25,000	(\$5,000)	(\$4,000)	(\$1,000)	(\$5,000)	(\$25,000)	\$36,000	(\$4,000)
Section 1231 Gain		\$5,000	\$25,000				\$10,000	\$30,000		\$70,000
Section 1231 (Loss)	(\$30,000)	-	-	(\$5,000)	(\$4,000)	(\$1,000)	(\$5,000)	(\$25,000)	\$0	(\$70,000)
Deferral Gain under Section 1400Z-2			-				(\$10,000)	(\$30,000)	\$36,000	(\$4,000)
Charac-										

FRONT-END TAX BENEFITS FROM DEFERRAL ELECTION, PLUS FIVE-YEAR CARRYBACK – ELIMINATION OF SECTION 1231(C) RECAPTURE – SECTION 1231 GAINS										
ter										
Ordinary Loss (Current Year)	(\$30,000)			(\$5,000)	(\$4,000)	(\$1,000)	(\$5,000)	(\$25,000)		(\$70,000)
							NOL Carried Back to 2014	NOL Carried Back to 2015		
Ordinary Gain (Recapture of Prior Ordinary Loss)		\$5,000	\$25,000							
NOL		(\$5,000)	(\$25,000)							(\$30,000)
		NOL from 2019	NOL from 2020							(2019–2020 NOL)
x 43.4% (Before 2018)	(\$13,020)	\$0	\$0	(\$2,170)	(\$1,736)	(\$408)	\$2,040	\$2,040	\$0	(\$8,766)
x 40.8% (After 2017)										

FRONT-END TAX BENEFITS FROM DEFERRAL ELECTION, PLUS FIVE-YEAR CARRYBACK – ELIMINATION OF SECTION 1231(C) RECAPTURE – SECTION 1231 GAINS										
Long-Term Capital Gain (LTC-G)									\$36,000	\$36,000
x 23.8% Rate =									\$8,568	\$8,568
Tax Benefit (Cost)	\$13,020	\$0	\$0	\$2,170	\$1,736	\$408	\$0	\$0	(\$8,568)	(\$8,766)

It should be noted, however, that these lucrative tax benefits of investing in a QOF and electing to defer gross section 1231 gains are generally available for those who received an allocation of such gains in 2020 from a partnership, S corporation, nongrantor trust or estate and invested such gains in a QOF by September 10, 2021, for partners in partnerships and S-corporation shareholders that are calendar-year taxpayers and by October 11, 2021, for beneficiaries of nongrantor trusts and estates.²⁰⁷ That is because, as discussed above, owners of such passthrough entities may choose to start their 180-day investment period on the due date (excluding extensions) of the passthrough entity's federal income tax return.²⁰⁸ Taxpayers can elect to defer gains previously invested in a QOF by these deadlines on their 2021 tax returns, filed by their extended due date in 2022.²⁰⁹

Furthermore, bipartisan legislation recently introduced in the U.S. Senate and House of Representatives known as the "Opportunity Zones Transparency, Extension, and Improvement Act" (S. 4065 and H.R. 4767) would extend the deferral period for

²⁰⁷ *Final Regulations on Opportunity Zones: Frequently Asked Questions*, DEPT. OF TREAS. (Dec. 19, 2019), <https://home.treasury.gov/system/files/136/Treasury-Opportunity-Zone-Final-Regulations-FAQ-12-19-19.docx>; Jimmy Atkinson, *Key Opportunity Zone Details for 2021, with Ashley Tison*, OPPORTUNITY ZONES DATABASE (Jan. 27, 2021), <https://opportunitydb.com/2021/01/ashley-tison-122/>.

²⁰⁸ Atkinson, *supra* note 207.

²⁰⁹ *Form 8997: Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments*, INTERNAL REVENUE SERVS., <https://www.irs.gov/pub/irs-pdf/f8997.pdf> (last visited Aug. 28, 2022).

QOF investments until December 31, 2028.²¹⁰ If this legislation is enacted in its current form, the bill's extension of the maximum period of deferral by another two years from the end of 2026 until the end of 2028, would also allow the same strategy employed above to be deployed by new investors in QOFs through 2023 with respect to their section 1231 gains realized in 2022.²¹¹

For investors seeking to elect to defer section 1231 gains from investments in a QOF, the added flexibility of the working capital safe harbor for QOZBs funded by June 29, 2021, discussed below, will be important by allowing taxpayers that invested in QOZB operating businesses through QOFs additional time to determine the precise nature of the project and business in which their capital will be deployed in a QOZ.²¹²

B. Explanation of Penalty Abatement Through 2021 for Certain QOFs

As discussed, section 1400Z-2(d)(1) defines a QOF as an investment vehicle that, among other things, holds at least 90% of its assets in QOZ Property, determined by the average of the percentages of QOZ Property held by that QOF (i) on the last day of the first six-month period of the tax year of the QOF, and (ii) on the last day of the tax year of the QOF. Section 1400Z-2(f)(1) imposes penalties on a QOF if the average of the percentages of its QOZ Property held on the semiannual testing dates is less than 90% for the tax year.²¹³ If the QOF fails to meet the 90% investment standard for the QOF tax year, the QOF must compute a monthly penalty under section 1400Z-2(f), based on the shortfall in each month that the entity was a QOF, multiplied by the federal tax underpayment rate for such month.²¹⁴ However, no such penalty is imposed “with respect to any failure [by a QOF to meet its 90% investment standard] if it is shown that such failure is due to reasonable cause.”²¹⁵

Notice 2021-10 deems a taxpayer's failure to satisfy the 90% investment standard for the QOF's tax year as due to reasonable cause (and hence not subject to penalties) if one or more semiannual testing dates in the tax year falls on or after April 1, 2020 and on or before June 30, 2021.²¹⁶ As a result, a partnership or corporation that elected to become a QOF at any time before February 2021 will not be subject to penalties under section 1400Z-2(f) for failing to satisfy the 90% investment standard in 2021.²¹⁷ Entities that use the calendar year as their tax and elected to become a QOF in 2020

²¹⁰ S. 4065, 117th Cong. § 301(a) (2022); H.R. 7467, 117th Cong. § 301(a) (2022).

²¹¹ See S. 4065, *supra* note 210; H.R. 7467, *supra* note 210 (proposing to allow deferral of, among other things, section 1231 gains realized in 2022 and invested in a QOF until December 31, 2028).

²¹² See I.R.S. Notice 2021-10, 2021-7 I.R.B. 890 (Feb. 16, 2021); *Discussion of the Opportunity Zone Program Including Final Regulations*, BDO INT'L (June 2020), <https://www.bdo.com/insights/tax/federal-tax/discussion-of-the-opportunity-zone-program>.

²¹³ I.R.C. § 1400Z-2(f)(1).

²¹⁴ See *id.*; *Instructions for Form 8996*, *supra* note 25.

²¹⁵ § 1400Z-2(f)(3).

²¹⁶ I.R.S. Notice 2021-10, 2021-7 I.R.B. 889 (Feb. 16, 2021).

²¹⁷ *Id.* at 888.

will be eligible for two years' penalties relief under Notice 2021-10, for their 2020 and 2021 tax years, potentially providing a corresponding amount of tax deferral without any requirement that QOFs invest any of their assets in a QOZ.²¹⁸

C. *30-Month Substantial Improvement Period Extended to Maximum 42 Months*

Section 1400Z-2(d)(2)(D)(i) of the Code and regulations thereunder provide that tangible property is treated as QOZ Business Property if the tangible property is used in a trade or business of the QOF, and such property: (1) was acquired by the QOF or QOZB after December 31, 2017 by purchase (as defined in Code section 179(d)(2)) from a person who is not a "related person" under Code section 1400Z-2(e)(2) (generally, using a 20% relatedness standard for entities, applying Code section 267(b) and 707(b)(1)), or by self-construction of such property, to the extent physical work of a significant nature begins with the eligible entity after December 31, 2017; (2) the original use of such property in the QOZ commences with the QOF or QOZB, or such property is substantially improved by the QOF or QOZB; and (3) during substantially all (at least 90%) of the QOF's or QOZB's holding period for such property, substantially all (at least 70%) of the use of such property was in a QOZ.²¹⁹

If a QOF or QOZB acquires property by purchase in a QOZ that has previously been placed in service in the QOZ by another taxpayer for purposes of depreciation or amortization, the QOF or QOZB that acquires the property must "substantially improve" it in order for the property to be considered QOZ Business Property.²²⁰ Property is "substantially improved" for this purpose "only if, during any 30-month period beginning after the date of acquisition of such property, additions to the basis with respect to such property in the hands of the qualified opportunity fund [or QOZB] exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund [or QOZB]" (the "30-month substantial improvement period").²²¹

Tangible property that is being substantially improved by a QOF or QOZB, but which has not yet been placed in service, may be treated as QOZ Business Property throughout the 30-month substantial improvement period if the QOF or QOZB reasonably expects that before the end of such 30-month period: (i) additions to the basis of such property will meet the substantially-improved property test; (ii) the property will be placed in service and used in the eligible entity's trade or business in a QOZ; and (iii) all other QOZ Business Property requirements with respect to the property will have been met with respect to the property.²²²

For purposes of the substantial improvement requirement with respect to previously-used, post-2017 acquired tangible property held by a QOF or QOZB, Notice 2021-10 tolls the 30-month substantial improvement period for the 12-month

²¹⁸ *Id.* at 890.

²¹⁹ § 1400Z-2(d)(2)(D); *see generally* Treas. Reg. § 1.1400Z2(d)-2.

²²⁰ Treas. Reg. § 1.1400Z2(d)-2(b)(3)(i)(C).

²²¹ I.R.C. § 1400Z-2(d)(2)(D)(ii); I.R.C. § 1400Z-2(d)(3)(A)(i).

²²² Treas. Reg. § 1.1400Z2(d)-2(b)(4).

period, beginning on April 1, 2020, and ending on March 31, 2021.²²³ Thus, an entity that begins the substantial improvement process with respect to a building or other tangible property at any time between January 2018 and April 2020 would have an additional 12 months on top of the standard 30-month period (for a maximum 42-month period) within which to more than double the adjusted basis of tangible property acquired after 2017 and previously used within the same QOZ in order for the property to be QOZ Business Property.²²⁴

Example 5: Maximum 42-Month Substantial Improvement Period. On April 1, 2020, a QOZB acquired a previously used commercial building in a QOZ for a cost of \$1 million, which the QOZB reasonably expects to place in service by September 30, 2023. During the 42 months between April 1, 2020, and September 30, 2023, the taxpayer's improvements to the building increase its adjusted basis in the building by more than \$1 million. Consequently, pursuant to Notice 2021-10's extension of the 30-month substantial improvement period, which disregards the period between April 1, 2020, and March 31, 2021, the QOZB satisfies the substantial-improvement test by more than doubling the basis of the property within a 30-month period deemed to commence on April 1, 2021, and end on September 30, 2023.

D. Explanation of COVID-19 Extension of Working Capital Safe Harbor for QOZBs

Under Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D), QOZBs with projects located in federally declared disaster areas, having a written plan and reasonable written schedule for spending working capital within 31 months, that otherwise satisfy the requirements of the 31-month working capital safe harbor, may receive not more than an additional 24 months (for a total of 55 months) to consume their working capital assets, provided the project is delayed due to that disaster.²²⁵ The final regulations did not specifically address whether QOZBs that otherwise meet the requirements to benefit from more than one application of the 31-month working capital safe harbor, for a total of 62 months, also benefit from an additional 24 months to spend their working capital from all such 31-month periods.

Notice 2021-10 modifies these rules for purposes of tolling all QOZBs' working capital safe harbor periods during 2020 and 2021 for working capital assets held for QOZ projects at any time during the period beginning on January 20, 2020 and ending on June 29, 2021.²²⁶

²²³ Notice 2021-10, *supra* note 15, at 889.

²²⁴ Jessica Millett, *2021 COVID-19 Timing Relief for QOFs, QOZBs, and Opportunity Zone Investors* (2021), Westlaw.

²²⁵ Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(B)-(D).

²²⁶ Notice 2021-10, *supra* note 15.

The notice incorporates four important modifications to the final regulations' provision for tolling the 31-month working capital safe harbor in the case of a federally declared disaster.²²⁷

First, *all QOZBs* holding cash, cash equivalents, or debt instruments with a term of 18 months or less covered by a 31-month working capital safe harbor for the development of a business in any QOZ during the period from January 20, 2020, to June 29, 2021, are automatically eligible for tolling of the 31-month working capital safe harbor, without showing that the COVID-19 emergency delayed their project.²²⁸ Second, QOZBs under Notice 2021-10 have a uniform period from January 20, 2020, to June 29, 2021, during which any working capital assets held under written working capital safe harbor plans and schedules that otherwise qualify for a 31-month safe harbor period will be eligible for the 24 months' extension described below.²²⁹ Third, a *uniform 24-month extension* applies to every QOZB holding working capital assets under a 31-month safe harbor between January 20, 2020, and June 29, 2021, regardless of when during that period the QOZB's 31-month working capital safe harbor began.²³⁰

Example 6: 24-Month Extension of the Working Capital Safe Harbor. On June 29, 2021, a QOZB first receives and allocates a cash contribution to working capital assets under a working capital plan with a 31-month schedule for use of the cash received on start-up costs consistent with the development of a manufacturing business in a QOZ that otherwise satisfies the working capital safe harbor. Notice 2021-10 would provide the QOZB a 24-month extension of the 31-month period within which to spend its working capital assets on such business for a total of 55 months' safe harbor, beginning in June 2021. Therefore, the QOZB could spend its cash infusion from June 29, 2021, at any time on or before December 31, 2025, while being protected by the working capital safe harbor for start-up businesses under Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v) and (vi).

Fourth, Notice 2021-10 clarifies how 24 months' disaster-related extensions apply to QOZBs that generally benefit from more than one 31-month working capital safe harbor periods, for a total of 62 months, in the form of successive applications of the working capital safe harbor for each tranche of capital raised for a project under an integrated master written plan covering multiple, substantial infusions of working capital, each independently satisfying the 31-month safe harbor for the use of working capital.²³¹ If QOZBs that have an integrated master plan in place for more than one 31-month working capital safe harbor periods, and one such 31-month period falls

²²⁷ *Id.* at 888.

²²⁸ *See* Millett, *supra* note 224.

²²⁹ *Id.*

²³⁰ Notice 2021-10, *supra* note 15, at 889.

²³¹ *Id.* at 888; *Multiple Working Capital Safe Harbors (Open Funds)*, OPPORTUNITY ZONE BLOG (Jan. 15, 2021), <https://ozinvested.com/oz-blogs/f/working-capital-safe-harbors-with-multiple-capital-infusions>.

between January 20, 2020, and June 29, 2021, then the maximum 62-month period is extended by 24 additional months to a maximum 86-month period.²³²

Example 7: 86-Month Working Capital Safe Harbor. Assume that on June 29, 2021, QOF contributes \$50x to a QOZB corporation in exchange for original-issue stock, consisting of almost all the QOZB's equity, to develop a large mixed-use real estate development that will consist of commercial and residential real property. To raise additional working capital for the mixed-use real estate development, QOZB also borrows \$25x in cash under a new revolving credit agreement with an unrelated lender on June 30, 2021. QOZB has a master written plan for the completion of the commercial and residential real property over a 62-month period. The plan provides that the commercial real property will be completed over a 31-month schedule and subsequently, the residential real property will be completed over a 31-month schedule. The plan further provides that a portion of the commercial real property is unable to be used in a trade or business after the completion of the commercial real property since that portion of the commercial real property will be unusable during the residential construction phase. Pursuant to QOZB's original master plan for the completion of the real estate development, QOF acquires \$50x in additional original-issue stock of QOZB for cash after the completion of the commercial development phase on January 1, 2024, and QOZB commences use of those working capital assets for the residential development phase, which is not completed until July 31, 2028.

Results under Notice 2021-10. QOZB's use of the cash for the commercial and residential phase qualified for the maximum 62-month working capital safe harbor, pursuant to the master written plan covering each tranche of capital received with respect to the development. In addition, at least one tranche of capital included under the master written plan began during the period from January 20, 2020, to June 29, 2021. Therefore, under Notice 2021-10, the QOZB can extend its coverage under the working capital safe harbors and ancillary safe harbors that protect its status as a QOZB for an additional 24 months to 86 months. This 86-month period ends on July 31, 2028, after all shareholders in the QOF have realized basis step-ups with respect to 10% of their investment in the QOF. When the QOZB's coverage under the working capital safe harbor lapses, the 10-year anniversary of QOF shareholders' investments will be only 34 months away, after which the QOZB may sold (excluding any inventory) tax free.

Under Notice 2021-10, the entity would be covered by the working capital safe harbor for up to 86 months. For the entirety of that entity's 86-month working capital safe harbor period, working capital assets that would otherwise be NQFP are excluded as reasonable amounts of working capital that will not cause the entity to fail to qualify as a QOZB. In addition, during the entity's start-up period, for up to 86 months, the entity will be treated as satisfying the QOZB requirement that at least 70% of its tangible property be held as QOZ Business Property. Further, any gross income that is derived from working capital assets during the QOZB's up-to-86-month working capital safe harbor period is counted toward satisfaction of the requirement that 50%

²³² Notice 2021-10, 2021-7 I.R.B. 888-89 (Feb. 16, 2021).

of the QOZB's gross income be earned from an active trade or business in a QOZ. And finally intangible property purchased or licensed by the QOZB during this working capital safe harbor period with such reasonable amounts of working capital will count towards the satisfaction of the requirement that 40% of the use of the QOZB's intangible property be in the active conduct of a trade or business in a QOZ.

In addition to Notice 2021-10, the Treasury Department and IRS issued Proposed Regulations (REG-121095-19), published in the Federal Register on April 14, 2021, that are intended to provide additional flexibility to QOZBs regarding the operation of the 24-month extension of the working capital safe harbor and the ability of such businesses to modify their working capital requirements and the planned use of their working capital assets in light of changes in their post-pandemic economic circumstances that may render their original working capital plans suboptimal or impracticable.²³³ Under the final regulations, it was unclear whether taxpayers receiving an additional 24 months to expend their working capital due to a federally-declared disaster were required to do so in a manner substantially consistent with their original, pre-disaster plan for development of a business in a QOZ.²³⁴

The proposed changes to the working capital safe harbor, on which taxpayers may rely for tax years beginning on or after January 1, 2020, permit QOZBs to revise or replace the original written designation and written plan to expend their working capital assets due to a federally-declared disaster (including, but not limited to, the ongoing COVID-19 disaster declared in every jurisdiction of the United States), within 120 days after the close of the "incident period," as defined by the Federal Emergency Management Agency (FEMA), as the time interval during which the disaster-causing incident that caused the damage or hardship to be alleviated by federal assistance occurs.²³⁵ The incident period for each disaster is established by FEMA in a legal agreement provided by FEMA stating the understandings, commitments, and binding conditions for assistance applicable under the Stafford Act as the result of the major disaster or emergency declared by the President in the applicable disaster area.²³⁶ Within 120 days of the end of this incident period, which has not occurred with respect to the COVID-19 disaster, QOZBs may therefore adopt a different written working capital safe harbor plan and schedule for use of the same or a lesser amount of working capital in the post-disaster environment on the ordinary start-up of a trade or business in a QOZ. The new or modified working capital safe harbor plan need not relate to the same business or be in the same census tract as the original, pre-disaster plan, provided that the post-disaster working capital plan and schedule provide for the planned completion of spending within the up-to-31 month or up-to-62-month period

²³³ Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D), 86 Fed. Reg. 19,585, 19,590 (Apr. 14, 2021).

²³⁴ See Treas. Reg. § 1.1400Z2(d)-1(d)(2)(v)(D) (requiring that the taxpayer otherwise meet the requirements for substantial consistency with their working capital plan and schedule).

²³⁵ Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D), 86 Fed. Reg. 19,596 (Apr. 14, 2021); 44 C.F.R. § 206.32(f) (2021).

²³⁶ § 206.32(f) (2021).

originally allowed, plus the up-to-24 additional months allowed by the extension for federally-declared disasters.²³⁷

E. Extension of QOFs' 12-Month Reinvestment Period

Generally, a QOF which realizes gain from the sale or exchange of an investment in QOZ Property has twelve months, beginning on the date of the disposition of the investment, to reinvest the amount received from the sale or exchanged in QOZ Property without failing the 90% asset test.²³⁸ However, this 12-month safe harbor applies only to the extent that prior to the reinvestment in QOZ Property, the QOF holds the proceeds continuously in the form of cash, cash equivalents, or debt instruments with a term of 18 months or less, and that some or all of the QOF's proceeds from a return of capital from, or a disposition of, QOZ Property is reinvested in QOZ Property by the last day of the 12-month period beginning on the date of the distribution, sale, or disposition, then the proceeds.²³⁹ If this safe harbor is satisfied, within the 12-month period, the QOF may treat the cash, cash equivalents and short-term debt instruments it has held since disposing of its QOZ Property as QOZ Property on each applicable semiannual testing date of the QOF until the QOF's acquisition of new QOZ Property allows the entity to actually satisfy its 90% investment standard under section 1400Z-2(d)(1) of the Code.²⁴⁰

However, an exception to the 12-month safe harbor for QOFs to reinvest proceeds from QOZ Property applies in the case of a federally-declared disaster, as defined in section 165(i)(5)(A) of the Code, such as that identified in the Major Disaster Declarations issued by the President, with respect to COVID-19 for each jurisdiction that includes a QOZ.²⁴¹ If the QOF's plan to reinvest some or all of the above-described proceeds in QOZ Property is delayed due to a federally declared disaster, identified in a disaster declaration issued under the Stafford Act, the QOF may receive not more than an additional 12 months to reinvest the proceeds, for a total of 24 months, provided that the QOF invests the proceeds in the manner originally intended before the disaster.²⁴²

Notice 2021-10's extension of the 12-month safe harbor for QOF reinvestment to 24 months could allow reinvestments of proceeds received by a QOF in the first half of 2020 as a return of capital from a QOZB, or from a sale or disposition of QOZ

²³⁷ See Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D), 86 Fed. Reg. 19,590 (Apr. 14, 2021); *Multiple Working Capital Safe Harbors (Open Funds)*, OPPORTUNITY ZONE BLOG (Jan. 15, 2021), <https://ozinvested.com/oz-blogs/f/working-capital-safe-harbors-with-multiple-capital-infusions>.

²³⁸ Treas. Reg. § 1.1400Z2(f)-1(b)(1).

²³⁹ Treas. Reg. § 1.1400Z2(f)-1(b)(1).

²⁴⁰ Treas. Reg. § 1.1400Z2(f)-1(b)(1).

²⁴¹ Treas. Reg. § 1.1400Z2(f)-1(b)(2); ERICA A. LEE ET AL., CONG. RSCH. SERV., R46809, FEDERAL EMERGENCY AND MAJOR DISASTER DECLARATIONS FOR THE COVID-19 PANDEMIC (2021); 26 U.S.C. § 165(i)(5).

²⁴² Treas. Reg. § 1.1400Z2(f)-1(b)(2); see generally LEE ET AL., *supra* note 241.

property, without violating its 90% investment standard, 24 months later in 2022.²⁴³ The prior provision under Notice 2020-39 for QOFs' 24-month reinvestment safe harbor only covered a return of capital from a QOZB or disposition proceeds from the sale or exchange of QOZ Property received between January 20, 2019 and January 20, 2020, which was before the months that were most affected by the pandemic.²⁴⁴

Notice 2021-10 therefore broadens the range of the 24-month reinvestment safe harbor to cover QOFs that would tend to be more impacted by the economic impact of COVID-19, compared to those with at least 12 months to reinvest a return of capital or disposition proceeds *before* the pandemic hit.²⁴⁵ Consider the following two examples:

Example 8: Reinvestment Safe Harbor for QOFs under Notice 2020-39. A QOF receives a return of capital from a QOZB on January 20, 2019, that it has 12 months to reinvest in QOZ Property if it holds those assets in working capital assets throughout the 12-month period. Since the 12-month reinvestment period would have ended on January 20, 2020, the QOF receives a 12-month extension of the reinvestment period (for a total of 24 months) to January 20, 2021, even though virtually all the reinvestment period occurred before the spread of the COVID-19 pandemic in the United States.

Example 9: Reinvestment Safe Harbor for QOFs under Notice 2021-10. A QOF receives a return of capital from a QOZB on March 13, 2020, the date on which the President of the United States declared a nationwide emergency with respect to COVID-19. Because the last day of the 12-month reinvestment period of the QOF would have otherwise fallen beyond January 20, 2020, this QOF received no relief under Notice 2020-39. However, under Notice 2021-10, this QOF would receive an additional 12-month reinvestment period, because its original 12-month period to reinvest the return of capital would have ended before July 1, 2021.

V. TABLE OF COVID-19 RELIEF PROVISIONS FOR QOFs AND INVESTORS

Additional details on the forms of relief provided under IRS Notices 2020-39 and 2021-10 are set forth in the following table. This table summarizes the five types of automatic COVID-19-related relief available under these notices for eligible taxpayers electing to defer and partially exclude capital gains timely rolled over into QOF investments, as well as the QOZBs in which such QOFs invest.

As this table indicates, the Treasury Department and IRS have significantly modified the QOZ program in response to the nationwide disaster caused by the COVID-19 pandemic. Many of these forms of relief will continue to pay dividends for QOZ funds, businesses, and investors for years to come and have substantially

²⁴³ See Notice 2021-10, 2021-7 I.R.B. 889 (Feb. 16, 2021).

²⁴⁴ *Relief for Qualified Opportunity Funds & Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic*, *supra* note 35.

²⁴⁵ *Extension of Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic*, INTERNAL REVENUE SERV., <https://www.irs.gov/pub/irs-drop/n-21-10.pdf> (last visited Aug. 28, 2022).

eased the burden of complying with various time-sensitive deadlines relating to this tax incentive program in the near term.

Beneficiaries	General Rule for 180-Day Investment Period	Applicable Period	Relief Provided	Procedural Requirements
<p>“Eligible taxpayers,” including any person that is required to report the recognition of capital gains during the tax year for federal income tax purposes, including individuals, partnerships, S corporations, C corporations (including regulated investment companies (RICs) and real estate investment trusts (REITs)), trusts, estates, and tax-exempt organizations and state colleges and</p>	<p>An eligible taxpayer receives the QOZ Program’s tax benefits by reinvesting some or all of their “eligible gain” (including capital gain and qualified section 1231 gain) into a QOF within a 180-day period, generally beginning on the date the gain would have been recognized for federal income tax purposes if the eligible taxpayer did not elect to defer recognition of that gain under section 1400Z-</p>	<p><i>Eligible taxpayers with 180-day periods beginning on or after Oct. 5, 2019, have until March 31, 2021, to make the investment in a QOF (the “Applicable Period”), even if the 180-day reinvestment period would have otherwise expired, including both:</i></p> <p>(a) <i>taxpayers that on or after October 5, 2019 realized eligible gain that would be recognized for federal income tax purposes if no election were made under section 1400Z-2(a)(1)(A) to defer recognition of that gain (a “deferral election”), including, but not limited to, those required to include a portion of their deferred gain from a QOF in income because of an inclusion events with respect to a QOF investment, and</i></p> <p>(b) <i>taxpayers that began a 180-day</i></p>	<p><i>180-day period extended to March 31, 2021 for 180-day periods that began on or after October 5, 2019, which would otherwise have expired on or before March 30, 2021.</i></p> <p>Any taxpayer that realized gain on October 5, 2019, would receive an extension of their 180-day period to 543 days within which to make a tax-deferred</p>	<p>Eligible taxpayers that invest in QOFs through March 31, 2021 automatically qualify for deferral with respect to eligible gain realized within the Applicable Period, but a taxpayer will still need to make a valid deferral election on <i>I.R.S. Form 8949, Sales and Other Dispositions of Capital Assets</i>, by attaching that form, together with <i>I.R.S. Form 8997, Initial and Annual Statements of Qualified Opportuni-</i></p>

<p>universities subject to tax on unrelated business taxable income under section 511.</p>	<p>2(a)(1)(A), subject to special rules in regulations promulgated thereunder for both (1) owners of partnerships and S corporations and beneficiaries of nongrantor trusts and estate (“<i>Passthrough Entities</i>”), who can choose a 180-day period beginning on the unextended due date of the passthrough’s federal income tax return (e.g., Mar. 16, 2020 for owners of partnership and S corporations in 2019, and Mar. 15, 2021 for such owners in 2020), and (2) taxpayers realizing certain</p>	<p><i>period for making an investment in a QOF on or after October 5, 2019, with respect to certain types of gain governed by special rules set forth in section 1400Z-2 regulations for determining when that period commences, including:</i></p> <p>(1) <i>2019 and 2020 qualified section 1231 gains</i> from the sale or exchange of business property held for more than one year, regardless of when that gain was realized;</p> <p>(2) <u>2019 and 2020 capital gains and qualified section 1231 gains received, or deemed to be received, from a Passthrough Entity</u> by a partner, S-corporation or beneficiary as a distributive share of income from a partnership, S corporation or nongrantor</p>	<p><i>investment in a QOF.</i></p> <p>Moreover, a calendar-year taxpayer with gain in one of the six categories listed in the immediately preceding column, with a 180-day realized on January 1, 2019, would have a total of 821 days from January 1, 2019 to March 31, 2021 within which to reinvest in a QOF and elect deferral.</p>	<p><i>ty Fund Investments</i>, to a timely-filed 2020 federal income tax return (including extensions) or an amended 2019 or 2020 federal income tax return, as applicable, for the tax year in which the eligible taxpayer would have taken the eligible gain into account for federal income tax purposes if no election on Form 8949 to defer the gain had been made.</p> <p>Even taxpayers in an overall net operating loss (“<i>NOL</i>”) position in 2019 or 2020 may seek to take advantage</p>
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	<p>types of capital gain treated as having a 180-day period that commences at year-end, including, but not limited to, section 1231 gains from 2019, net 1256 gains for 2019 or 2020, gain from 2019 or 2020 installment sales, and REIT and RIC shareholders' capital gain dividends and undistributed capital gains respectively received or recognized in the 2019 or 2020 tax year.</p>	<p>trust or estate, respectively;</p> <p>(3) <i>2019 and 2020 net capital gain from contracts marked to market under section 1256</i> (including regulated futures contracts, foreign currency contracts, nonequity options, dealer equity options and dealer securities futures contracts), and net capital gain during the tax year from an identified straddle or mixed straddle account from section 1256 contracts and other positions marked to market on the last business day of the taxable year, to the extent gain from such straddles can be deferred under section 1400Z-2(a)(1)(A) and Treas. Reg. § 1.1400Z2(a)-</p>		<p>of Notice 2021-10 to defer and potentially reduce Eligible Gain realized as the deferral election may generate additional NOL refund opportunities under the 5-year carry back rules enacted as part of the CARES Act.</p>
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		<p>1(b)(11)(vi)(C) ;</p> <p>(4) <i>2019 and 2020 eligible gain from installment sales, taken into account pursuant to the installment method under section 453, so long as the last day of the taxable year in which one or more payments under the installment sale was received was on or after October 5, 2019 (e.g., December 31, 2019, and December 31, 2020, for calendar-year taxpayers), regardless of when the installment sale occurred or when during the taxable year payment was received;</i></p> <p>(5) <i>2019 and 2020 capital gains dividends received by a shareholder of a real estate investment trust (REIT) or regulated</i></p>		
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		<p><i>investment company (RIC) designated for that shareholder by the REIT or reported for that shareholder by the RIC for that shareholder's tax year ending on or after October 5, 2019; and</i></p> <p><i>2019 and 2020 undistributed capital gains retained by a REIT or RIC for a tax year that is designated for inclusion in shareholder income for that shareholder's taxable year if either (i) the last day of that shareholder's tax year or (ii) the last day of the REIT or RIC's tax year ends on or after October 5, 2019.</i></p>		
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Beneficiaries	General Rule for QOF Penalties under Section 1400Z-2(f)	Applicable Period	Relief Provided	Procedural Requirements
Qualified Opportunity Funds (QOFs)	A QOF must hold on average at least 90% of its assets in QOZ Property (the "90% Investment Standard"), as measured by	QOFs for which (1) the last day of the first 6-month period of the tax year of the QOF falls between April 1, 2020, and June 30, 2021, or (2) the last day of	Abatement of any and all penalties in tax years 2020 and 2021 under section 1400Z-2(f)	QOF must still accurately complete and timely file Form 8996, Qualified Opportunity Fund, for 2020 and/or 2021, as applicable,

	<p>the percentages of QOZ Property held in the QOF on (1) the last day of the first 6-month period of the tax year of the QOF, and (2) the last day of the tax year of the QOF (each, a “semiannual testing date”).</p> <p>If the QOF fails to satisfy the 90% requirement, the QOF must pay a penalty for each month it fails to meet the requirement, equal to the shortfall multiplied by the underpayment rate established under section 6621(a)(2), unless reasonable cause is shown for the failure.</p>	<p>the tax year of the QOF, falls between April 1, 2020 and June 30, 2021, including:</p> <p>(1) QOFs organized as partnerships or corporations for federal income tax purposes and self-certified as QOFs on or before January 31, 2021;</p> <p>(2) All other self-certified QOFs with a fiscal tax year ending between April 1, 2020, and June 30, 2021; and</p> <p>(3) All QOFs dissolved or otherwise decertified on or before June 30, 2021.</p>	<p>that would otherwise be imposed on QOFs with at least one semiannual testing date in the applicable period between April 1, 2020, and June 30, 2021.</p>	<p>but mark “0” in Part IV, Line 8 (Penalty).</p> <p>For a QOF that is seeking to mitigate penalties, while preserving deferral through 2021, by decertifying before the expiration of the relief from penalties, the QOF must accurately complete and timely file Form 8996, Qualified Opportunity Fund, for 2021, and follow the instructions to be provided by the IRS with respect to voluntary decertification. While the draft version of Form 8996 allowed QOFs to decertify by checking a box on Line 6 of Part I in the form, this option was removed from the final version of Form 8996, published in</p>
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				February 2021, leaving the process for QOF decertification to future revisions of the form.
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Beneficiaries	General Rule for 31-Month and 62-Month WCSH	Applicable Period	Relief Provided	Procedural Requirements
Qualified Opportunity Zone Businesses (QOZBs)	Final regulations under section 1400Z-2 generally provide a QOZB with one or more periods of 31 months from the date of receipt by the QOZB of each debt or equity infusion to spend working capital held throughout the 31-month period in cash, cash equivalents and debt instruments with a term of 18 months or less (“ <i>working capital assets</i> ”), and spent in accordance with a written plan and	<i>Any QOZB with a WCSH plan and schedule</i> that otherwise satisfies the safe harbor’s requirements at any time between <i>January 20, 2020</i> and <i>June 29, 2021</i> .	All QOZBs holding working capital assets intended to be covered by an otherwise valid 31-month WCSH schedule that includes some or all of the period between January 20, 2020 and June 29, 2021, may receive (1) not more than 24 months’ extension of the 31-month WCSH for total of <i>55 months to expend working capital assets during the applicable 31-month safe-harbor period</i> , and (2) if covered by an	None, other than having a written WCSH plan and 31-month written schedule in place for expending working capital assets in place by June 29, 2021.

	<p>schedule (“31-month WCSH”), provided that the maximum period of time for a QOZB to benefit from multiple 31-month WCSH periods cannot exceed 62 months in the aggregate (“62-month WCSH”).</p> <p>If, however, a QOZB project that otherwise meets the requirements of the 31-month WCSH is located within a QOZ designated as a part of a federally declared disaster area, such as COVID-19 disasters declared in every QOZ beginning on January 20, 2020, the QOZB may receive up to an additional 24 months to consume its working capital assets, provided the project is</p>		<p>integrated master plan in place for spending working capital from multiple cash infusions, not more than 24 months’ extension of the 62-month WCSH for a total of 86 months in the aggregate to spend all working capital assets covered by more than one 31-month WCSH periods.</p>	
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Beneficiaries	General Rule for 30-Month Substantial Improvement Period	Applicable Period	Relief Provided	Procedural Requirements
QOFs and QOZBs undertaking the substantial improvement of tangible property between April 1, 2020 to March 31, 2021.	If the QOF or QOZB is <i>not</i> the first person to place tangible property into service in a QOZ, the QOF or QOZB must “substantially improve” the property for such property to be Qualified Opportunity Zone Business Property (“QOZBP”). Tangible property is treated as substantially improved by a QOF (or QOZB) only if, during <i>any 30-month period, beginning after the acquisition date of such property</i> , additions to the basis of	30-month substantial improvement periods with respect to tangible property that include some or all of the period <i>between April 1, 2020 and March 31, 2021</i> .	Tolls the 30-month substantial improvement period for QOFs and QOZBs with respect to tangible property undergoing improvement at any time during the 12 months from <i>April 1, 2020 to March 31, 2021</i> . QOFs and QOZBs that are substantially improving property throughout Notice 2021-10’s tolling period for substantial improvement receive a maximum 42-month substantial improvement period to more than	None, except that only QOFs and QOZBs that are actually improving tangible property that has been previously used within a QOZ will benefit from the longer period in which to more than double such property’s basis following the tolling period from April 1, 2020 to March 31, 2021.

	<p>the property in the hands of the QOF (or QOZB) exceed the QOF or QOZB's adjusted basis of that property as of the beginning of that 30-month period (<i>"30-month substantial improvement period"</i>).</p> <p>For QOFs and QOZBs, tangible property purchased for use in a trade or business that is undergoing the substantial improvement process, but has not been placed in service or used by the applicable entity in its trade or business, satisfies the requirements of being QOZ Business Property for the 30-month substantial improvement period with respect to that property.</p>		<p>double the basis of tangible property, and any QOF or QOZB that initially acquires and commences substantial improvement of tangible property between April 1, 2020 and March 31, 2021 will <i>not be required to make additions to the basis of property exceeding at least 100% of the property's adjusted basis at the beginning of the substantial improvement period before September 30, 2023</i> (after 30 months beginning on April 1, 2021).</p>	
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Beneficiaries	General Rule for QOFs Reinvesting Proceeds from QOZ Property within 12 Months	Applicable Period	Relief Provided	Procedural Requirements
<p>QOFs that receive a return of capital from a qualifying investment in a QOZB or proceeds from the sale or disposition of QOZ property between January 20, 2019 and June 30, 2020.</p>	<p>Final regulations under section 1400Z-2 generally provide a QOF with a period of 12 months to reinvest the return of capital from investments in QOZ Stock and QOZ Partnership Interests of a QOZB, and to reinvest proceeds received from the sale or disposition of QOZ Property without paying a penalty under section 1400Z-2(f).</p> <p>However, the QOF may extend its reinvestment period to 24 months if a QOF's plan to reinvest some or all of its</p>	<p>Relief is available only if a QOF received a return of capital from a QOZB, such as a distribution by the QOZB to the QOF to the extent that it does not exceed the amount of capital that the QOF originally invested in the QOZB, or proceeds the sale, exchange or other disposition of QOZ property <i>between January 20, 2019 and June 30, 2020.</i></p> <p>Note: there is nothing that a QOF can do prospectively to trigger this provision, since the return of capital or</p>	<p>Extends from 12 to 24 months QOFs' safe-harbor period for reinvesting proceeds from the return of capital on, or the sale or disposition of, QOZ property, if such proceeds were received during <i>the 18-month period between January 20, 2019 and June 30, 2020</i> (that is, during this period of the federally-declared disaster for the COVID-19 pandemic).</p> <p>QOFs receive up to an additional 12 months on top of the otherwise applicable 12-month safe</p>	<p>No procedural requirements but proceeds from QOZ Property must be continuously held in working capital assets and reinvestment of QOZ Property must be within the same QOZ(s) as originally contemplated before COVID-19 emergency.</p>

	<p>proceeds in QOZ Property is delayed due to a federally declared disaster, including, but not limited to, those declared for the COVID-19 pandemic in every jurisdiction where a QOZ is located beginning on January 20, 2020, provided that the QOF invests such proceeds in the manner originally intended before the disaster.</p>	<p>disposition proceeds would have to have been received by the QOF and held as working capital assets since June 30, 2020.</p>	<p>harbor (for a total of 24 months) to reinvest some or all of the proceeds from a return of capital or sale or other disposition of QOZ Property <i>received any time between January 20, 2019 and June 30, 2020</i>, provided that (1) the QOF continuously holds such proceeds before their reinvestment in cash, cash equivalents, or debt instruments with a term of 18 months or less, and (2) reinvests the proceeds in the manner originally intended before June 30, 2020.</p>	
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