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June 27, 2019

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CC:PA:LPD:PR (REG-120186-18), Room 5203

Internal Revenue Service

P.O. Box 7604, Ben Franklin Station

Washington, DC 20044

Submitted electronically at [www.regulations.gov](http://www.regulations.gov)

Re: Treasury Notice 84 Fed. Reg. 18652 (5/1/19): Comments on Proposed Regulations on Qualified Opportunity Funds under Code Section 1400Z-2

Dear Ladies and Gentlemen,

I respectfully request to speak at the public hearing on the proposed regulations on qualified opportunity funds under Code Section 1400Z-2 scheduled for July 9, 2019, beginning at 10 a.m., at the New Carrollton Federal Building at 5000 Ellin Road, Lanham, Maryland 20706.

I will speak on behalf of The American College of Trust and Estate Counsel (“ACTEC”), and have set forth below an outline of the topics I will address and the amount of time that I plan to devote to each topic.

Further consideration should be given concerning the income tax consequences resulting from the death of a taxpayer who has deferred gain through a timely reinvestment of gain in a Qualified Opportunity Fund (“QOF”) to provide relief for successors-in-interest 2 minutes

The Proposed Regulations should be revised to provide that a donor’s gift of an interest in a QOF generally should not be an event that causes inclusion of deferred gain 3 minutes

Clarification should be provided concerning grantor trusts, including to confirm that a transaction with a grantor trust that is disregarded for income tax purposes pursuant to Rev. Rul. 85-13 should not be considered a sale or exchange of an interest in a QOF 2 minutes

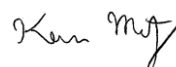
Further relief to extend the 180-day period for rollover of gain to a QOF should be granted to partners, S corporation shareholders and beneficiaries of estates and trusts because they may not receive a Schedule K-1 indicating capital gains until more than 180 days after the end of the taxable year 2 minutes

Guidance is requested to clarify the availability of the step-up in basis upon death to the extent that the value of the QOF investment at death exceeds the deferred gain amount 1 minute

These topics are addressed in the enclosed Comments submitted by ACTEC.

Thank you for allowing me this opportunity to speak

Sincerely,



Kevin Matz

*Board of Regents*

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Washington, DC 20044

Submitted electronically at [www.regulations.gov](http://www.regulations.gov)

Re: Treasury Notice 84 Fed. Reg. 18652 (5/1/19): Comments on Proposed Regulations on Qualified Opportunity Funds under Code Section 1400Z-2

Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel (“ACTEC”) is pleased to submit the enclosed comments pursuant to Treasury Notice 84 Fed. Reg. 18652, published in the Federal Register on May 1, 2019. ACTEC commends Treasury and the IRS for their efforts in quickly drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations. ACTEC’s comments focus primarily on the application of the proposed regulations to trusts and estates.

ACTEC is a professional organization of approximately 2,500 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift and GST tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

If you or your staff would like to discuss the comments, please contact Kevin Matz, who led the task force that put together the comments, at (212) 806-6076 or [kmatz@stroock.com](mailto:kmatz@stroock.com). Don Kozusko, Chair of the ACTEC Washington Affairs Committee, at (202) 457-7211 or [dkozusko@kozlaw.com](mailto:dkozusko@kozlaw.com), or Deborah McKinnon, ACTEC Executive Director, at (202) 684-8460 or [domckinnon@actec.org](mailto:domckinnon@actec.org).

Respectfully submitted,



John A. Terrill, II  
ACTEC President 2019-2020

Attachments

## **Comments of the American College of Trust and Estate Counsel (“ACTEC”) on Proposed Regulations under Code Section 1400Z-2 Concerning Qualified Opportunity Funds**

Treasury Notice 84 Fed. Reg. 18652 (5/1/19) requested comments on proposed regulations issued under section 1400Z-2 of the Code concerning qualified opportunity funds (“QOFs”)<sup>1</sup> (the “Second Set of QOF Proposed Regulations”).<sup>2</sup> This follows Treasury Notice 83 Fed. Reg. 54279 (10/29/18), which had likewise requested comments on proposed regulations issued under section 1400Z-2 of the Code concerning QOFs (the “First Set of QOF Proposed Regulations”).<sup>3</sup> ACTEC submitted its comments to the First Set of QOF Proposed Regulations on December 27, 2018,<sup>4</sup> with its principal focus primarily on the application of the proposed regulations to trusts and estates. In this comment letter, we again focus on the application of the proposed regulations to trusts and estates. We again commend Treasury and the IRS for their efforts in quickly drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations.

### **BACKGROUND**

Section 1400Z-2 contains a new tax incentive provision that is intended to promote investment in economically-distressed communities, referred to as “Opportunity Zones.” Through this program, investors can achieve the following three significant tax benefits:

1. The deferral of gain on the disposition of property to an unrelated person until the earlier of the date on which the subsequent investment is sold or exchanged, or December 31, 2026, so long as the gain is reinvested in a QOF within 180 days of the property’s disposition;
2. The elimination of up to 15% of the gain that has been reinvested in a QOF provided that certain holding period requirements are met;<sup>5</sup> and

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<sup>1</sup> Unless otherwise stated, references herein to “section(s)” or to “Code” are to the Internal Revenue Code of 1986, as amended. References herein to “§” are to relevant sections of the Treasury regulations.

<sup>2</sup> The Second Set of QOF Proposed Regulations can be found at the following link: <https://www.federalregister.gov/documents/2019/05/01/2019-08075/investing-in-qualified-opportunity-funds>

<sup>3</sup> The First Set of QOF Proposed Regulations can be found at the following link: <https://www.federalregister.gov/documents/2018/10/29/2018-23382/investing-in-qualified-opportunity-funds>

<sup>4</sup> ACTEC’s comments to the First Set of QOF Proposed Regulations is set forth at the following link: <https://www.actec.org/assets/1/6/ACTEC-comments-to-Treasury-re-Qualified-Opportunity-Funds-2018-12-27.pdf>

<sup>5</sup> This is accomplished through basis adjustments. Section 1400Z-2(b)(2)(B)(iii) provides that in the case of any investment in a QOF that is held for at least five years, the basis of such investment shall be increased by ten percent (10%) of the deferred gain. In addition, section 1400Z-2(b)(2)(B)(iv) provides for

3. The potential elimination of tax on gains associated with the appreciation in the value of a QOF, provided that the investment in the QOF is held for at least ten years.

An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Internal Revenue Service (IRS). All Opportunity Zones have now been designated, as of June 14, 2018, and are available on the U.S. Department of Treasury website. See <https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>

A QOF, in turn, is an investment vehicle that is established as either a domestic partnership or a domestic corporation for the purpose of investing in eligible property that is located in an Opportunity Zone and uses investor gains from prior investments as a funding mechanism.

To become a QOF, the entity self-certifies itself. The entity must meet certain requirements, in particular a general requirement that at least 90% of its assets be “qualified opportunity zone property” used within an Opportunity Zone, but no approval or action by the IRS is required. To self-certify, the entity completes Form 8996, and then attaches that form to the entity’s timely-filed federal income tax return for the taxable year (taking into account extensions).<sup>6</sup>

## **DISCUSSION**

### **1. Further consideration should be given concerning the income tax consequences resulting from the death of a taxpayer who has deferred gain through a timely reinvestment of gain in a QOF to provide relief for successors-in-interest**

Section 1400Z-2(e)(3) provides that, “[i]n the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.” This statutory provision raises questions concerning the appropriate treatment of the deferred gain where a person who has rolled over gain through a timely investment in a QOF dies prior to December 31, 2026 without having previously disposed of the QOF investment.

The Second Set of QOF Proposed Regulations resolved these questions consistent with section 691. It states that, as a general rule, “a transfer of a qualifying investment by reason of the taxpayer’s death is not an inclusion event,”<sup>7</sup> and provides the following examples:

- (A) A transfer by reason of death to the deceased owner’s estate;
- (B) A distribution of a qualifying investment by the deceased owner’s estate;

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an additional five percent (5%) increase in the basis of the QOF investment if it is held by the taxpayer for at least seven years.

<sup>6</sup> The IRS Form 8996 and the instructions thereto are set forth at the following links: <https://www.irs.gov/pub/irs-pdf/f8996.pdf> and <https://www.irs.gov/pub/irs-pdf/i8996.pdf>.

<sup>7</sup> Prop. Reg. § 1.1400Z2(b)-1(c)(4)(i).

- (C) A distribution of a qualifying investment by the deceased owner's trust that is made by reason of the deceased owner's death;
- (D) The passing of a jointly owned qualifying investment to the surviving co-owner by operation of law; and
- (E) Any other transfer of a qualifying investment at death by operation of law.<sup>8</sup>

The Second Set of QOF Proposed Regulations then specifies that the following transfers are **not** considered transfers by reason of the taxpayer's death, and thus are inclusion events, with the amount recognized to be includible in the gross income of the transferor as provided in section 691.

- (A) A sale, exchange or other disposition by the deceased taxpayer's estate or trust, other than a distribution described in items (A) – (E) above.
- (B) Any disposition by the legatee, heir, or beneficiary who received the qualifying investment by reason of the taxpayer's death; and
- (C) Any disposition by the surviving joint owner or other recipient who received the qualifying investment by operation of law on the taxpayer's death.<sup>9</sup>

The preamble to the Second Set of QOF Proposed Regulations (at pages 56-57) explains this as follows:

Nevertheless, in part because of the statutory direction that amounts recognized that were not properly includible in the gross income of the deceased owner are to be includible in gross income as provided in section 691, ***the Treasury Department and the IRS have concluded that the distribution of the qualifying investment to the beneficiary by the estate or by operation of law is not an inclusion event for purposes of section 1400Z-2(b)***. Thus, the proposed regulations would provide that neither a transfer of the qualifying investment to the deceased owner's estate nor the distribution by the estate to the decedent's legatee or heir is an inclusion event for purposes of section 1400Z-2(b). Similarly, neither the termination of grantor trust status by reason of the grantor's death nor the distribution by that trust to a trust beneficiary by reason of the grantor's death is an inclusion event for purposes of section 1400Z-2(b). In each case, the recipient of the qualifying investment has the obligation, as under section 691, to include the deferred gain in gross income in the event of any subsequent inclusion event, including for

example, any further disposition by that recipient. (emphasis added)

The Second Set of QOF Proposed Regulations expressly confirm that the recipient of a qualifying investment by reason of the death of the owner may ***tack*** the decedent's holding period for purposes of the basis adjustments that can result from holding an interest in a QOF

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<sup>8</sup> Prop. Reg. § 1.1400Z2(b)-1(c)(4)(i)(A)-(E).

<sup>9</sup> Prop. Reg. § 1.1400Z2(b)-1(c)(4)(ii).

for five or seven years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.<sup>10</sup>

In the discussion that follows, we first describe how section 691 operates and then address the application of section 691 to interests in QOFs including the consequences that may visit the beneficiary of a decedent's interest in a QOF who continues to hold the QOF interest on December 31, 2026. We then set forth our proposal to ameliorate certain harsh tax consequences that may befall a beneficiary who inherits a QOF interest but may lack the financial wherewithal to pay the tax come December 31, 2026.

### **Section 691**

Section 691 sets forth the rules that apply to a person's receipt of income in respect of a decedent ("IRD"). IRD refers to income earned by a decedent who was a cash basis taxpayer prior to his or her death, but that is not properly includible in income until after the decedent's death. IRD is not reportable on the decedent's final income tax return. Rather, it is reportable by the recipient of the IRD item (e.g., by the decedent's estate or some other person).<sup>11</sup>

Since items of IRD are subject to both income and estate taxes, the recipient is allowed an income tax deduction for the proportionate share of the estate tax (and generation-skipping transfer ("GST") tax) attributable to the IRD item.<sup>12</sup> This deduction mitigates, to some extent, the burden of double taxation.

One very significant aspect of IRD is that section 1014(c) denies a step-up in basis at death to items of IRD.

Analogous to those rules relating to income in respect of a decedent is section 691(b), which addresses deductions and credits in respect of a decedent -- which are incurred prior to death but are not properly allowable until after death.<sup>13</sup> Because the deductible payments would have reduced the decedent's taxable income and payment would have reduced the decedent's gross estate for estate tax purposes, deductions in respect of a decedent are excepted from the section 642(g) limitation that denies an income tax deduction if an estate tax deduction is allowed for the same item postmortem.<sup>14</sup>

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<sup>10</sup> Prop. Reg. § 1.1400Z2(b)-1(d)(1)(iv). ACTEC expressly requested confirmation as to this in its comment letter on the First Set of QOF Proposed Regulations and appreciates having received this clarification.

<sup>11</sup> IRD can include, for example, the following: (i) income earned by an employee for services performed prior to his or her death but which is not received by the recipient until after the employee has died, (ii) rents earned by the decedent prior to death but not paid until after the decedent's death, (iii) an employee's interest in a qualified retirement plan, and (iv) a person's interest in an individual retirement account ("IRA").

<sup>12</sup> See section 691(c).

<sup>13</sup> Itemized under section 691(b)(1) are only the section 162 (business expenses), 163 (interest), 164 (taxes), 212 (expenses of producing income or managing or safeguarding income producing property), and 611 (percentage depletion) deductions, and the section 27 foreign tax credit.

<sup>14</sup> See section 642(g) (last sentence).

Certain transfers of the right to receive income in respect of a decedent cause an acceleration of the income represented by that right.<sup>15</sup> Includible in the transferor's gross income for the taxable year of the transfer is the greater of the amount of any consideration received for the transfer or the fair market value of the right at the time of the transfer. Some transfers are excepted: for example, transfers by the decedent's estate to any beneficiary to whom the right was specifically bequeathed or as part of the residue passing to a residuary beneficiary are not acceleration events<sup>16</sup> and distributions by a trustee in similar circumstances presumably should be accorded similar treatment (although the law is unclear on this).<sup>17</sup> On the other hand, certain distributions are sure to trigger acceleration: for example, distributions in satisfaction of pecuniary bequests are acceleration events,<sup>18</sup> and an estate beneficiary who receives the right to income in respect of the decedent in a nonaccelerating distribution will cause an acceleration by making a gift of the right to a third party.<sup>19</sup>

### ***Application of Section 691 to QOFs***

The application of these rules to QOFs would seem to be as follows. Suppose that D has a \$2,000,000 capital gain on April 1, 2019 and timely reinvests it in a QOF on July 1, 2019. D then dies four years later – on July 1, 2023. At the time of D's death, D's interest in the QOF is worth only \$100,000. D's Will gives his interest in the QOF to his child, C, as part of the residue of the estate. On December 31, 2026, the interest in the QOF is worth \$1,000,000.

Of particular relevance to these facts, section 1400Z-2(b)(2) contains a special rule that caps the amount of the gain so as not to exceed the fair market value of the investment as of the date that the gain is included in income. It provides as follows:

#### **1400Z-2(b)(2) AMOUNT INCLUDIBLE.—**

**1400Z-2(b)(2)(A) IN GENERAL.—** The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of—

**1400Z-2(b)(2)(A)(i)** the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over

**1400Z-2(b)(2)(A)(ii)** the taxpayer's basis in the investment.

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<sup>15</sup> Section 691(a)(2).

<sup>16</sup> Treas. Reg. §1.691(a)-4(b). *Cf.* Private Letter Ruling 200234019 (allocation in satisfaction of pick and choose fractional residuary bequest to charity was not an acceleration event).

<sup>17</sup> It is clear that a terminating distribution by a trust is not an acceleration event. See Treas. Reg. § 1.691(a)-4(b)(3). In contrast, the section 691(a)(2) exception for estate distributions that do not generate acceleration does not list trust interim transfers.

<sup>18</sup> Section 691(a)(2).

<sup>19</sup> Treas. Reg. § 1.691(a)-4(a) (penultimate sentence).

Taking this special rule into account, it would appear that D's disposition under his Will of his interest in the QOF to C as part of the residue of the estate should not trigger the inclusion of income. ***But what happens on December 31, 2026?*** It would appear that at that point C would recognize income of \$700,000, which is the amount of deferred gain capped at the fair market value of the investment in the QOF at that time (\$1,000,000) reduced by basis adjustments of \$300,000 ( $\$2,000,000 \times 15\% = \$300,000$ ) attributable to the 5 year and 7 year holding periods under section 1400Z-2(b)(2)(B)(iii) and (iv). ***However, C may or may not have the liquidity necessary to pay the deferred tax that becomes due at that time. This could be particularly problematic to C if the fund does not contain redemption provisions, or if a secondary market for the interest in the fund has not matured.***

One possible approach to help mitigate this potentially serious liquidity concern of a beneficiary could be to give the successor-in-interest upon the taxpayer's death (including the personal representative of the decedent's estate) the ability to elect to treat the taxpayer's death as a recognition event for income tax purposes. In accordance with the principles set forth in Rev. Rul. 86-72<sup>20</sup> and *Estate of Frane v. Commissioner*,<sup>21</sup> the income would be properly reported by the decedent's estate on its Form 1041 fiduciary income tax return, and not on the decedent's final Form 1040 individual income tax return.<sup>22</sup> This solution, however, is not without its own potentially significant complications, as the successor-in-interest may be a fiduciary with a duty of impartiality with respect to all of the beneficiaries of the decedent's estate. In addition, the fiduciary may itself be a beneficiary of the decedent's estate, and potentially could stand to benefit from the consequences of any such election. So although there may be some appeal to providing such a solution on behalf of the successor-in-interest, it may be too problematic, all things considered.

Rather, we believe that the better approach would be to allow the successor-in-interest to be able to continue to defer the gain under section 691 (including after December 31, 2026) until the time that the successor-in-interest disposes of its interest in the QOF. Such disposition could be governed by the principles of section 691 that are described above with respect to the disposition of IRD. By adopting this rule, the successor-in-interest could be protected from inheriting a potentially significant tax liability without having the liquidity to pay for it.

## **2. The Proposed Regulations should be revised to provide that a donor's gift of an interest in a QOF generally should not be an event that causes inclusion of deferred gain**

Section 1400Z-2(b)(1) provides for the deferral of gain that is invested in opportunity zone property until the earlier of "the date on which such investment is ***sold or exchanged***, or

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<sup>20</sup> 1986-1 C.B. 253. In this Revenue Ruling, the IRS held that installment obligations that self-canceled upon the seller's death were treated as transfers that triggered the section 691(a)(2) income acceleration rule, and the outstanding gain was recognized by and includible in the gross income of the seller's estate.

<sup>21</sup> 998 F.2d 567 (8th Cir. 1993), *aff'g in part and rev'g in part*, 98 T.C. 341 (1992).

<sup>22</sup> In *Frane*, the Tax Court and the United States Court of Appeals for the Eighth Circuit held that cancellation of a self-canceling installment note was an income taxable event. Consistent with Rev. Rul. 86-72, the Eighth Circuit ruled that the income is properly reported by the decedent's estate on its Form 1041 fiduciary income tax return, reversing the Tax Court's holding that the income was reported on the decedent's final Form 1040 individual income tax return.



December 31, 2026.” (emphasis added) A gift of an interest in a QOF is generally neither a sale nor an exchange.<sup>23</sup> Accordingly, we respectfully request that guidance be provided that a gift of an interest in a QOF should not be considered a sale or exchange for purposes of section 1400Z-2(b), provided that the gift is not otherwise treated by the tax law as a taxable disposition for income tax purposes.<sup>24</sup>

The Second Set of QOF Proposed Regulations take a different approach, however, and treats a gift (other than to a grantor trust) as an inclusion event. Specifically, Prop. Reg. § 1.1400Z2(b)-1(c)(3) provides that “[a] taxpayer’s transfer of a qualifying investment by gift, whether outright or in trust, is an inclusion event, regardless of whether that transfer is a completed gift for Federal gift tax purposes, and regardless of the taxable or tax-exempt status of the donee of the gift.” Prop. Reg. § 1.1400Z2(b)-1(c)(5) provides an exception to this general rule in the case of grantor trusts. In this regard, Prop. Reg. § 1.1400Z2(b)-1(c)(5)(i) provides that “[i]f the owner of qualifying investment contributes it to a trust and, under the grantor trust rules, the owner of the investment is the deemed owner of the trust, the contribution is not an inclusion event.” In addition, Prop. Reg. § 1.1400Z2(b)-1(c)(5)(ii) addresses changes in grantor trust status, and states that “a change in the status of a grantor trust, whether the termination of grantor trust status or the creation of grantor trust status, is an inclusion event” but then provides an exception to inclusion event treatment where grantor trust status terminates “as a result of the death of the owner a qualifying investment” with the provisions of Prop. Reg. § 1.1400Z2(b)-1(c)(4) (as discussed in Part 1 above) applying to distributions or dispositions by the trust.

The preamble to the Second Set of QOF Proposed Regulations (at pages 39-41) address the “sale or exchange” requirement of section 1400Z-2(b)(1) in the following manner:

Section 1400Z-2(b)(1) provides that the amount of gain that is deferred if a taxpayer makes an equity investment in a QOF described in section 1400Z-2(e)(1)(A)(i) (qualifying investment) will be included in the taxpayer’s income in the taxable year that includes the earlier of (A) the date on which the qualifying investment is sold or exchanged, or (B) December 31, 2026. By using the terms “sold or exchanged,” section 1400Z-2(b)(1) does not directly address non-sale or exchange dispositions, such as gifts, bequests, devises, charitable contributions, and abandonments of qualifying investments. ***However, the Conference Report to accompany H.R. 1, Report 115-466 (Dec. 15, 2017) provides that, under section 1400Z-2(b)(1), the “deferred gain is recognized on the earlier of the date of which the qualify[ing] investment is disposed of or December 31, 2026.” See Conference Report at 539. (emphasis added)***

The proposed regulations track the disposition language set forth in the Conference Report and clarify that, subject to enumerated exceptions, an inclusion event results from a transfer of a qualifying investment in a transaction to the extent the transfer

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<sup>23</sup> Section 102.

<sup>24</sup> An exception to this general rule could apply, for example, if the donor’s interest in the QOF is encumbered by debt in excess of basis. See Treas. Reg. § 1.1001-1(e)(1).

reduces the taxpayer's equity interest in the qualifying investment for Federal income tax purposes. . . .

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Based upon the guidance set forth in the Conference Report and the principles underlying the "inclusion event" concept described in the preceding paragraphs, the proposed regulations provide taxpayers with a nonexclusive list of inclusion events, which include: . . . . (4) A transfer by gift of a qualifying investment . . . ."

The preamble employs an expansive reading of the Conference Report to effectively overrule the statutory language of section 1400Z-2(b)(1) which speaks explicitly about a "sale or exchange." The full language of the Conference Report on sections 1400Z-1 and 1400Z-2 of the Code, however, does not demonstrate that the expansive reading was what Congress intended. The Conference Report consistently refers to a "sale or exchange" as the inclusion event without showing any intent to use a different standard for inclusion or a broad novel meaning for the "sale or exchange" terminology.

The Conference Report states that "[t]he provision provides for the temporary deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and permanent exclusion **from the sale or exchange of an investment in the qualified opportunity fund.**" (Conference Report at 537-38) (emphasis added). On page 539, in commenting on the basis adjustment mechanisms, the Conference Report provides as follows:

If the investment in a qualified opportunity zone fund is held by the taxpayer for at least five years, the basis on the original gain is increased by 10 percent of the original gain. If the opportunity zone asset or investment is held by the taxpayer for at least seven years, the basis on the original gain is increased by an additional 5 percent of the original gain. The deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of or December 31, 2026. Only taxpayers who rollover capital gains of non-zone assets before December 31, 2026, will be able to take advantage of the special treatment of capital gains for non-zone and zone realizations under the provision.

The Conference Report continues as follows on page 539 of the Conference Report (emphasis added) in a context where one might more likely expect Congress to express its intent concerning the meaning of the phrase "sale or exchange" -- but no such expression of intent is provided:

The second main tax incentive in the bill excludes from gross income the post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years. Specifically, **in the case of a sale or exchange of an investment in a qualified opportunity zone held for more than 10 years**, at the election of the taxpayer the basis of such investment in the hands of the taxpayer shall be the fair market value of the investment **at the date of such sale or exchange**. Taxpayers can

continue to recognize losses associated with investments in qualified opportunity zone funds as under current law.

Viewing the provisions on QOFs in the Conference Report as a whole, there does not appear to be any indication of Congressional intent to give a meaning to the phrase “sale or exchange” contained in section 1400Z-2(b)(1) that is expressly contrary to its unambiguous language.

Moreover, the requirement that Treasury Regulations construe unambiguous statutory language in accordance with its plain meaning was recently illustrated in *Kress v. United States*.<sup>25</sup> In *Kress*, the court determined that a requirement contained in section 2703(b)(2) applies only with respect to transfers at death, and not with respect to lifetime transfers, since the statutory language makes reference to “members of the decedent’s family.” The court rejected the IRS’s argument that the requirement applied to both transfers at death as well as to inter vivos transfers, based upon the broader language contained in Treasury Regulation § 25.2703-1(b)(1)(ii) which provides that “[t]he right or restriction is not a device to transfer property to the natural objects of the transferor’s bounty . . . .” The court noted that “[i] reviewing an agency’s interpretation of a statute, the court must first determine ‘whether Congress has directly spoken to the precise question at issue . . . . If so, the court must give effect to the statute’s unambiguous language and end the inquiry, ‘for the court, as well as the agency, must give effect to the unambiguously express intent of Congress.’” In rejecting the IRS’s broader interpretation of the requirement as being applicable to both transfers at death and lifetime transfers, the court indicated that it was clear from the statute’s use of the term “decedent” that the statute “unambiguously limits its application to transfers at death.”

Accordingly, we respectfully request that guidance be provided to instead clarify that a gift of an interest in a QOF should not be considered a sale or exchange for purposes of section 1400Z-2(b), provided that the gift is not otherwise treated by the tax law as a taxable disposition for income tax purposes. We further request that clarification be provided to confirm that such a gift does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or seven years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

Further, along these same lines, we also request clarification concerning the following:

- That a transaction between spouses for which the nonrecognition provisions of section 1041 apply should not be considered an inclusion event;<sup>26</sup> and
- That distributions from a trust (be it from a grantor trust or from a nongrantor trust) to either an individual or to another trust (including but not limited to another trust established under the same governing instrument) that do not result in gain or loss for income tax purposes without regard to section 1400Z-2 shall not be considered inclusion events.

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<sup>25</sup> No. 16-C-795 (E.D.Wis. March 26, 2019).

<sup>26</sup> Section 1041 generally provides that no gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of) (1) a spouse or (2) a former spouse (in the case of a former spouse, where such transfer is incident to divorce). Under section 1041(c), a transfer of property is considered incident to divorce if such transfer (1) occurs within one year after the date on which the marriage ceases, or (2) is related to the cessation of the marriage.

**3. Clarification should be provided concerning grantor trusts, including to confirm that a transaction with a grantor trust that is disregarded for income tax purposes pursuant to Rev. Rul. 85-13 should not be considered a sale or exchange of an interest in a QOF**

Clarification is requested concerning grantor trusts, specifically with respect to the income tax consequences that would result from a transaction between a grantor and a grantor trust where Rev. Rul. 85-13<sup>27</sup> would otherwise cause it to be a non-recognition event for income tax purposes.

The grantor trust rules are set forth in sections 671 through 679. These rules generally provide that if certain rights or powers are retained, the grantor (or other individual treated as the “owner” for income tax purposes) will be required to include all (or a portion) of the gains, losses, deductions and credits attributable to the trust on his or her own personal income tax return. Consistent with the grantor trust rules, it should not matter whether the gain that is sought to be deferred, or the funds that are subsequently invested in the QOF, belong to the taxpayer or to such taxpayer’s grantor trust. We accordingly request clarification to this effect.

In addition, pursuant to Rev. Rul. 85-13, transactions between a grantor and such person’s grantor trust are disregarded for federal income tax purposes.

Prop. Reg. § 1.1400Z2(b)-1(c)(5)(i) provides that “[i]f the owner of a qualifying investment **contributes** it to a trust and, under the grantor trust rules, the owner of the investment is the deemed owner of the trust, the contribution is not an inclusion event.” (emphasis added) In addition, Prop. Reg. § 1.1400Z2(b)-1(c)(5)(ii) addresses “changes in grantor trust status,” and states that “a change in the status of a grantor trust, whether the termination of grantor trust status or the creation of grantor trust status, is an inclusion event.” It then provides an exception to inclusion event treatment where grantor trust status terminates “as a result of the death of the owner of a qualifying investment” with the provisions of Prop. Reg. § 1.1400Z2(b)-1(c)(4) (as discussed in Part 1 above) applying to distributions or dispositions by the trust.

Pages 55 and 56 of the preamble to the Second Set of QOF Proposed Regulations address a transaction with a grantor trust in the following limited manner (note per the emphasis added the use of the phrase “by gift” instead of “contributes”):

However, a transfer of a qualifying investment **by gift** by the taxpayer to a trust that is treated as a grantor trust of which the grantor is the deemed owner is not an inclusion event. The rationale for this exception is that, for Federal income tax purposes, the owner of the grantor trust is treated as the owner of the property in the trust until such time that the owner releases certain powers that cause the trust to be treated as a grantor trust. Accordingly, the owner’s qualifying investment is not reduced or eliminated for Federal income tax purposes upon the transfer to such a grantor trust. However, any change in the grantor trust status of the trust (except by reason of the grantor’s death) is an inclusion event because the owner of the trust property for Federal income tax purposes is changing.<sup>28</sup>

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<sup>27</sup> See Rev. Rul. 85-13, 1985-1 C.B. 184.

<sup>28</sup> The effect of the grantor’s death in the case of a grantor trust is discussed in Part 1 above.

We would assume, based on the language of the preamble, that the proposed regulations' reference to the word "contributes" is intended to include transfers "by gift" and we respectfully request clarification of such point. But the scope of Rev. Rul. 85-13 extends well beyond that and necessarily embraces **all transactions** between the grantor and such grantor's grantor trust during the grantor's lifetime and, as such, could include (i) the creation of a grantor trust funded with a gift of a QOF interest, (ii) a sale of a QOF interest between the grantor or the grantor trust, (iii) the exercise of a so-called "swap power" described in section 675(4)(C) to reacquire the trust corpus by substituting other property of an equivalent value, where such power is exercisable in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity, or (iv) a transfer by a grantor trust of a QOF interest to a grantor (for instance, in satisfaction of an annuity interest or an installment payment due under a promissory note). Accordingly, a sale, swap or other transaction of an interest in a QOF between a grantor and such person's grantor trust should not be considered a sale or exchange of an interest in a QOF, and therefore should not trigger the recognition of gain. We request that this be confirmed as well.

In addition, Prop. Reg. § 1.1400Z2(b)-1(c)(5)(ii) seems overly broad and should be corrected. As written, the first sentence of that proposed regulation reads: "(ii) Changes in grantor trust status. In general, a change in the status of a grantor trust, whether the termination of grantor trust status or the creation of grantor trust status, is an inclusion event." This statement, however, is too broad. Based upon the literal language of this statement, if the taxpayer personally owned a QOF investment and was also the grantor of a grantor trust that **did or did not own a QOF investment**, the change in the trust's grantor trust status could be read to potentially constitute an inclusion event and would trigger the acceleration of the deferred gain on the taxpayer's personally-owned QOF investment. The triggering of an inclusion event and the acceleration of deferred tax, however, should only be conditioned in the context of that trust owning a QOF investment and that specific trust's change in tax status. This overbreadth concern can be addressed by modifying the first sentence of Prop. Reg. § 1.1400Z2(b)-1(c)(5)(ii) to read as follows (with the new language indicated in bold):

"(ii) Changes in grantor trust status. In general, a change in the status of a grantor trust **that holds a qualifying investment**, whether the termination of grantor trust status or the creation of grantor trust status, is an inclusion event."

We further request that clarification be provided to confirm that transactions between a grantor and such person's grantor trust does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or seven years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years. Prop. Reg. § 1.1400Z2(b)-1(d)(1)(iv) already provides, in relevant part, that "the holding period of a qualifying investment held by a taxpayer who received that qualifying investment as a gift that was not an inclusion event . . . includes the time during which that qualifying event was held by the donor . . . ." This proposed regulation should be broadened to encompass the other types of transactions involving grantor trusts that are discussed in this Part 3.

- 4. Further relief to extend the 180-day period for rollover of gain to a QOF should be granted to partners, S corporation shareholders and beneficiaries of estates and trusts because they may not receive a Schedule K-1 indicating capital gains until more than 180 days after the end of the taxable year**

Section 1400Z-2(a)(2) provides that, to qualify for the tax benefits that can be derived through an investment in a QOF, the taxpayer's rollover of gain to the QOF must occur during the 180-day period beginning on the date of the sale or exchange that gives rise to such gain.

The proposed regulations provide some relief to the above rule in the case of certain pass-through entities including beneficiaries of trusts and estates.

- First, the proposed regulations include special provisions by which gain recognized by a partnership may flow through to the partners and be reinvested by the partners in a QOF (except to the extent the partnership elects to rollover the gain itself).<sup>29</sup>
- Second, there is the potential for partners to have an increased period during which to reinvest gain in a QOF. The partnership's 180-day period begins on the date of its sale, but if the gain flows through to the partners, the partners' 180-day period generally begins on the last day of the partnership's taxable year.<sup>30</sup>

The proposed regulations state that rules analogous to the partnership and partner guidance indicated above apply to other pass-through entities (including S corporations, decedents' estates, and trusts) and to their shareholders and beneficiaries.<sup>31</sup> In addition, the preamble to the proposed regulations requests comments concerning whether taxpayers would benefit from further clarification in the context of S corporations, decedents' estates and trusts.

The chief administrative difficulty that taxpayers will have with these rules is the clear potential for an "information gap" to exist between the partnership, S corporation, executor and trustee, on the one hand, and the partner, S corporation shareholder, and beneficiary on the other hand. The Schedule K-1 is the mechanism for a partnership, S corporation, estate or trust to report tax attributes – including capital gains – not only to the Internal Revenue Service, but also to the partner, S corporation shareholder or beneficiary, as the case may be. If the tax return for the passthrough entity is placed on extension, there will be a substantial possibility that the Schedule K-1 will not be issued until more than 180 days after the end of the tax year, at which point the opportunity to roll over gain to a QOF will have been lost.

This information gap problem can be especially pronounced in the case of certain estates and trusts. Under section 663(b), a fiduciary is permitted to elect to treat a distribution made in the first 65 days of the tax year as having occurred on the last day of the preceding tax year. Such a distribution could involve capital gains that, as a result of the section 663(b) election, may be treated by the estate or trust as having been distributed to the beneficiary on the last day of the preceding tax year. The beneficiary would not become aware of this in the ordinary course until it receives the Schedule K-1 reporting such distributed gains. As noted above, this may potentially occur more than 180 days after the end of the estate's or trust's tax year if the Form 1041 fiduciary income tax return is on extension.

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<sup>29</sup> Prop. Reg. §1.1400Z2(a)-1(c)(2).

<sup>30</sup> Partners may instead elect to use the partnership's 180-day period if they so desire (e.g., if the desired investment is already lined up). See Prop. Reg. §1.1400Z2(a)-1(c)(2)(iii)(B).

<sup>31</sup> Prop. Reg. §1.1400Z2(a)-1(c)(3).

Furthermore, the 180-day periods for the partnership, S corporation, executor and trustee, as the case may be, and the partner, S corporation shareholder or beneficiary, as the case may be, can overlap. If the partnership, S corporation, executor and trustee are deemed to sell property on the last day of the tax year (*e.g.*, December 31<sup>st</sup>) resulting in capital gains, the 180-day periods can coincide. This overlap can be problematic in alerting taxpayers on a timely basis of the existence of capital gains that are eligible to be rolled over to a QOF.

To be consistent with the objectives of the statute -- which is to promote investment in economically distressed communities with capital gains as the funding mechanism for such investment -- we believe that in the case of partners, S corporation shareholders, and beneficiaries of estates or trusts, the due date for a partner, S corporation shareholder or beneficiary to elect to defer gains by reinvesting in a QOF should instead be the later of (i) 180 days after the end of the relevant tax year (which is the current rule under the proposed regulations) and (ii) 180 days after the timely filing (taking into account extensions) of the tax return for the partnership, S corporation, estate or trust that has incurred such gain.

These concerns – and our proposed solution – are illustrated by the following example.

Suppose that X Estate is a calendar year estate that has \$5 million of capital gains during the year ending December 31, 2018, which it distributes to Y (a beneficiary of X Estate) on February 28, 2019. The estate elects under section 663(b) to treat this distribution of capital gains as having been made by the estate on December 31, 2018 and further elects to treat this distribution as carrying out to Y distributable net income (DNI) under section 643(a). X Estate timely extends the due date for filing its Form 1041 fiduciary income tax return and eventually files its 2018 Form 1041 with the Internal Revenue Service on September 1, 2019 and mails out its Schedule K-1 to Y, who receives it on September 5, 2019. Y timely files her 2018 individual income tax return on October 1, 2019, and her tax return does not contain an election to rollover gain to a QOF.

Absent further relief, Y would not have received any formal notice (in the form of a Schedule K-1) of her eligibility to rollover this gain to a QOF until after June 29, 2019 (which is 180 days after December 31, 2018). To remedy this, we would propose that Y instead be given the opportunity to rollover her deferred gain to a QOF under these facts until February 28, 2020 – which is 180 days after the timely filing (including extensions) of X Estate’s 2018 Form 1041 with the Internal Revenue Service on September 1, 2019. Y would report this election to defer gain that she has timely rolled over to a QOF on her 2018 individual income tax return, including (as may be warranted) on an amended 2018 individual income tax return that attaches Form 8949 that she subsequently files with the Internal Revenue Service within the period prescribed by section 6511.

#### **5. Guidance is requested to clarify the availability of the step-up in basis upon death to the extent that the value of the QOZ investment at death exceeds the deferred gain amount**

As discussed in Part 1 above, Section 1400Z-2(e)(3) provides that, “[i]n the case of a decedent, **amounts recognized under this section** shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.” (emphasis added) The implication of this statutory provision is that to the extent a decedent’s investment in a QOF does **not** consist of “amounts recognized under this section,” such portion, upon the taxpayer’s death, should **not** constitute income in respect of a decedent (IRD) under section 691 (so as to result in a denial of a step-up in basis upon death under section 1014(c)) and should therefore be eligible to receive a step-up in basis upon death under section 1014(a).

This matter takes on additional practical complexity in light of section 1400Z-2(b)(2), which as discussed in Part 1 above, contains a special rule that caps the amount of the gain so as not to exceed the fair market value of the investment as of the date that the gain is included in income.<sup>32</sup>

The application of these rules to QOFs would seem to work as follows, and we request that clarification be provided to this effect. Suppose that D has a \$2,000,000 capital gain on April 1, 2019 and timely reinvests it in a QOF on July 1, 2019. D then dies four years later on July 1, 2023. At the time of D's death, D's interest in the QOF is worth \$3,000,000. Based upon the application of the above rules, the \$2,000,000 deferred gain would **tentatively** constitute IRD under section 691 and therefore, pursuant to section 1014(c), would *not* be eligible for a step-up in basis upon death under section 1014(a). We use the phrase "**tentatively** constitute IRD under section 691" to denote that the amount of the deferred gain as of D's death could be subject to subsequent adjustments after D's death to take into account, among other things, the basis adjustments attributable to the 5 year and 7 year holding periods under section 1400Z-2(b)(2)(B)(iii) and (iv) and the fair market value cap limitation of section 1400Z-2(b)(2).

In contrast, the \$1,000,000 in appreciation in the value of D's investment as of D's date of death **does not constitute an amount "recognized under this section"** and therefore should be eligible to receive a step-up in basis upon death under section 1014(a). Accordingly, D's estate or other successor-in-interest should have a basis of \$1,000,000 in the QOF investment immediately following D's death. The same result should be produced even if, as a result of QOF entity operations during D's lifetime (including potentially through partnership indebtedness, allocations of income or losses and the receipt of distributions), there has been an adjustment to D's basis in the QOF investment during D's lifetime. Instead, such adjustments to basis during D's lifetime should operate to decrease the amount of the deferred gain (which would otherwise **tentatively** constitute IRD under section 691 upon D's death) in a manner similar to the basis adjustments attributable to the 5 year and 7 year holding periods under section 1400Z-2(b)(2)(B)(iii) and (iv) and the basis adjustment that would occur upon the recognition of gain on December 31, 2026 under section 1400Z-2(b)(2)(B)(ii).<sup>33</sup> Moreover, this result of a \$1,000,000

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<sup>32</sup> Section 1400Z-2(b)(2) provides as follows:

**1400Z-2(b)(2) AMOUNT INCLUDIBLE.—**

**1400Z-2(b)(2)(A) IN GENERAL.—** The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of—

**1400Z-2(b)(2)(A)(i) --** the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over

**1400Z-2(b)(2)(A)(ii) --** the taxpayer's basis in the investment.

<sup>33</sup> These provisions provide as follows:

**Section 1400Z-2(b)(2)(B)(ii) INCREASE FOR GAIN RECOGNIZED UNDER SUBSECTION (a)(1)(B).—**

The basis in the investment shall be increased by the amount of gain recognized by reason of subsection (a)(1)(B) with respect to such property.

**Section 1400Z-2(b)(2)(B)(iii) INVESTMENTS HELD FOR 5 YEARS.—** In the case of any investment held for at least 5 years, the basis of such investment shall be increased by an amount equal to 10 percent of the amount of gain deferred by reason of subsection (a)(1)(A).



basis in the QOF investment upon D's death under section 1014(a) should be unaffected by any decline in the value of the QOF interest subsequent to D's death that operates to invoke the fair market value cap limitation of section 1400Z-2(b)(2).

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**Section 1400Z-2(b)(2)(B)(iv) INVESTMENTS HELD FOR 7 YEARS.—** In the case of any investment held by the taxpayer for at least 7 years, in addition to any adjustment made under clause (iii), the basis of such property shall be increased by an amount equal to 5 percent of the amount of gain deferred by reason of subsection (a)(1)(A).