

DECERTIFICATION OF QUALIFIED OPPORTUNITY FUNDS

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I. INTRODUCTION

Congress added the Qualified Opportunity Zone (“QOZ”) Program as part of the Tax Cuts and Jobs Act of 2017¹ as a community development tax incentive to stimulate investment in certain economically distressed areas by providing for special treatment of capital gains invested in designated lower-income census tracts. The federal tax benefit under the QOZ program flow to investors in a self-certified investment vehicle known as a “qualified opportunity fund,” or “QOF.”²

In November 2020, the Internal Revenue Service (“IRS”) released draft instructions for *Form 8996, Qualified Opportunity Fund*, on which eligible entities, classified as partnerships or domestic corporations for federal income tax purposes, elect to self-certify as QOFs, which provided a simple and easy means for such a fund to decertify as a QOF: The applicable fund simply checked a box on Line 6 of Form 8996, which under the section 1400Z-2 regulations causes investors in the decertified QOF to recognize eligible gain deferred upon the investment in the QOF. Without explanation, however, Line 6 was removed from the final version of Form 8996 for 2021 so that no voluntary self-decertification election was ever actually made by

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¹ An Act to Provide the Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Pub. L. No. 115-97, 131 Stat. 2054, 2184, § 13823(a) (Dec. 22, 2017) (commonly referred to as the “Tax Cuts and Jobs Act of 2017” or “TCJA”), as amended by the Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64, 161 § 41115 (Feb. 9, 2018), (codified, as amended, at I.R.C. §§ 1400Z-1, 1400Z-2).

² See I.R.C. § 1400Z-2(a)(1)(A) (describing the tax deferral election that taxpayers must make to realize benefits under the Qualified Opportunity Zone Program upon a timely investment made within 180 days of a gain-realization event in a “qualified opportunity fund”); I.R.C. § 1400Z-2(d)(1) (defining a “qualified opportunity fund” for purposes of section 1400Z-2); I.R.C. § 1400Z-1(a) (defining a “qualified opportunity zone” in which a qualified opportunity fund must invest directly or indirectly through its acquisition of qualified opportunity zone property).

taxpayers on that form.³ Under the final regulations, as originally drafted, the QOF was required to self-decertify by notifying the IRS of the partnership or corporation's intention not to be a QOF in accordance with forms and instructions promulgated by the IRS.⁴ Thus, the self-decertification rule made QOFs dependent on the IRS providing guidance on the procedures for voluntary decertification, which have yet to be released in any form on which a taxpayer can rely.⁵ Moreover, the original regulations on self-decertification prohibited a QOF's voluntary self-decertification from being effective any earlier than the first day of the month following the month in which the fund informs the IRS—in accordance with IRS forms and instructions—that the eligible entity is decertifying as a QOF.⁶

With the proliferation of failed businesses during the early days of the COVID-19 emergency, these dual requirements of IRS forms and instructions and the timing of income recognition from a self-decertification became untenable and many tax lawyers and advisors resorted to filing protective decertification elections with the IRS service center with which the fund's federal income tax returns were filed, intending to preserve the ability to deem the decertification of the fund to have occurred no later than the first day of the month following the mailing of the decertification notice to the IRS.⁷ But this means of voluntary self-decertification remains without the imprimatur of IRS forms, instructions or guidance, so that QOFs are still unsure when, if ever, such a protective filing may be effective to decertify a QOF in order to avoid cascading penalties that accrue once a QOF is not pursuing, directly or through a qualified opportunity zone business (“QOZB”), a trade or business located in a QOZ census tract.⁸

³ See I.R.S. Draft Form 8996, Qualified Opportunity Fund, at *1–2 (Nov. 6, 2020) (“*Do not file draft forms and do not rely on draft forms, instructions, and publications for filing.*”) (emphasis original).

⁴ Treas. Reg. § 1.1400Z2(d)-1(a)(3) (as amended in 2020).

⁵ See, e.g., Letter from Joseph Darby, Joseph Darby Law, to the Honorable Lily Batchelder, Assistant Secretary (Tax Policy), U.S. Dep’t of the Treasury, at *2–3 (May 26, 2022) (referencing the IRS National Office’s response that it lacked the statutory or regulatory authority to revoke inadvertent QOF self-certification elections made by entities intending to be classified as qualified opportunity zone businesses in 2019).

⁶ See T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1978 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (“The self-decertification becomes effective at the beginning of the month following the month specified by the taxpayer, *which month must not be earlier than the month in which the taxpayer files its self-decertification* as provided in paragraph (a)(3)(i) of this section [that is, ‘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 . . .’]”) (emphasis added).

⁷ See *id.*

⁸ See generally Letter from Joseph Darby, *supra* note 5 at *2 (stating that in response to a private letter ruling request, involving three entities’ erroneous self-certification as QOFs, that the taxpayers received a “letter from the IRS National Office to the applicable parties indicating that the IRS felt it did not have authority to revoke the [QOF self-certification] ‘elections’ made on Form 8996 for the 2019 Federal income tax returns, based on lack of statutory or regulatory authority on the part of the IRS to revoke such ‘election’”).

A second issue with the lack of a self-decertification process has arisen with inadvertent filing errors made by QOZBs that filed Form 8996.⁹ QOZBs are entities in which QOFs typically invest in order to satisfy the requirement that ninety percent of a QOF's assets be held in qualified opportunity zone property ("QOZP"), including qualified opportunity zone stock and partnership interests in a QOZB and qualified opportunity zone business property ("QOZBP").¹⁰ But a QOF cannot invest in another QOF.¹¹ And, although a QOZB's tangible property may be reported on a Form 8996 filed by the QOFs that invest in a QOZB, there is no comparable form for a QOZB.¹² Forms 8996 are used by domestic partnerships and corporations to self-certify their status as QOFs and report their compliance with the aforementioned ninety percent investment standard or pay a penalty for noncompliance with such standard.¹³ Because a QOZB needs to invest seventy percent of its tangible property in QOZBP, which is a type of QOZP, and Question 2 at the top of Form 8996 asks whether "the taxpayer is organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)," the accountants for three eligible entities intending to be classified as QOZBs for the 2019 tax year erroneously filed Form 8996 for that year, resulting in the IRS issuing a Letter 6501 to each of the QOFs invested in the three entities indicating that the Form 8996 filed by the QOF reported an investment in another QOF based on the reported EINs shown with respect to their QOZP investments in Parts VI and VII of the form.¹⁴ Such an investment by a QOF in another QOF would void the QOF status of the investor entities.¹⁵ If an eligible entity, intending to be classified as a QOZB in which one or more QOFs invest, inadvertently files Form 8996 for a single tax year, it is considered a self-certified QOF until that self-certification is revoked.¹⁶ According to a letter from the IRS National Office to a QOF seeking a private letter ruling to allow three eligible entities in which it invested to revoke their erroneous QOF self-certification on Form 8996, "the IRS felt it did not have authority to revoke the [QOF] 'elections' made on Form 8996 for the 2019 Federal income tax returns, based on lack of statutory or regulatory authority on the part of the

⁹ See *id.* at *2–3.

¹⁰ I.R.C. § 1400Z-2(d)(2)(A)–(D).

¹¹ I.R.C. § 1400Z-2(d)(1) (flush language).

¹² QOFs report tangible property of each QOZB held on the semiannual testing dates of the QOF in Parts VI and VII of Form 8996. See I.R.S. Form 8996, Qualified Opportunity Fund, Part VI, Columns (d), (e) Tangible property held by QOZBs that are held by a QOF on the QOF's semiannual testing dates

¹³ I.R.S., Instructions for Form 8996, at *1 (as revised in Dec. 2021).

¹⁴ Letter from Joseph Darby, *supra* note 5, at *2.

¹⁵ I.R.C. § 1400Z-2(d)(1) ("The term "qualified opportunity fund" means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (*other than another qualified opportunity fund*) . . .") (emphasis added).

¹⁶ See Treas. Reg. § 1.1400Z2(d)-1(a)(2)–(3) (as amended in 2020).

IRS to revoke such ‘election,’” according to a letter submitted by an attorney for the applicable entities to the Assistant Secretary of the Treasury for Tax Policy on May 26, 2022.¹⁷

While the history of Form 8996 provided no hint as to the IRS’s procedures for voluntary self-decertification of a QOF, the Treasury Department and the IRS changed the self-decertification regulation in significant ways under correcting amendments issued on August 5, 2021 (the “2021 correcting amendments”), that may point toward a new approach to the time, place and manner of QOFs’ decertification elections.¹⁸ In the 2021 correcting amendments, the Treasury Department and the IRS expurgated all language relating to the time when a QOF’s self-decertification election becomes effective so that QOFs are no longer (necessarily) hamstrung by the federal government’s failure to promulgate procedures to allow QOFs to voluntarily decertify as such.¹⁹ In particular, the regulation on self-decertification of a QOF was amended as follows:

Treas. Reg. § 1.1400Z2(d)-1(a)(3) Self-decertification of a QOF. — If a QOF chooses to self-decertify as a QOF, ~~the following rules apply:~~

~~Treas. Reg. § 1.1400Z2(d)-1(a)(3)(i) Form and Manner. — The self-decertification must be effected in such form and manner as may be prescribed by the Commissioner in IRS forms or instructions or in publications or guidance published in the Internal Revenue Bulletin (see §§601.601(d)(2) and 601.602 of this chapter).~~

~~Treas. Reg. § 1.1400Z2(d)-1(a)(3)(ii) Time. — The self-decertification becomes effective at the beginning of the month following the month specified by the taxpayer, which month must not be earlier than the month in which the taxpayer files its self-decertification as provided in paragraph [§ 1.1400Z2(d)-1(a)(3)(i) of this section.~~

The 2021 correcting amendments also included changes to the Preamble to the final regulations on Investing in Qualified Opportunity Funds, which are of similar effect, and read as follows:

In the October 2018 proposed regulations, the Treasury Department and the IRS announced an intention to publish additional guidance regarding QOF decertification. *See* 83 FR 54283 (September 29, 2018). Comments were

¹⁷ *See* Letter from Joseph Darby, *supra* note 5, at *2.

¹⁸ *See* Treas. Reg. §1.1400Z2(d)-1(a)(3), as amended by T.D. 9889, 86 Fed. Reg. 42716 (Aug. 5, 2021) (effective on August 5, 2021 and applicable on or after January 13, 2020); *see also* T.D. 9889, 86 Fed. Reg. 42715 (Aug. 5, 2021) (corrections to Preamble, effective on August 5, 2021 and applicable on or after January 13, 2020).

¹⁹ *See id.*

received on this topic, including comments requesting a mechanism to permit a QOF to self-decertify, as well as comments requesting guidance on the ability of the IRS to decertify a QOF. ~~The Treasury Department and the IRS have included in the final regulations a provision to allow a QOF to self decertify. This rule specifies that self decertification becomes effective at the beginning of the month following the month specified by the taxpayer. The month specified by the taxpayer must not be earlier than the month in which the taxpayer files its self decertification. For example, if a QOF wishes to decertify on May [sic], the earliest date that the QOF could be decertified would be June 1st, provided that all applicable procedures were followed.~~

The Treasury Department and the IRS are developing additional instructions regarding QOF self-decertification, including instructions regarding the time, form, and manner of QOF self-decertification. Additionally, the Treasury Department and the IRS continue to consider the circumstances under which involuntary decertification of a QOF would be warranted and intend to propose guidance regarding those circumstances. As noted in part III.A. of this Summary of Comments and Explanation of Revisions, the final regulations include a rule providing that the decertification of a QOF, whether voluntary or involuntary, is an inclusion event for eligible taxpayers that hold a qualifying investment in that QOF. See [Treas. Reg.] §1.1400Z2(b)-1(c)(15).²⁰

These amendments reflect an important, albeit necessary, change with respect to the timing of the self-decertification's effective date and the filing of a decertification election in such form and manner as may be prescribed by the Commissioner of Internal Revenue in future IRS forms and instructions. Without this change, under amended Treas. Reg. § 1.1400Z2(d)-1(a)(3), QOFs, which cannot now decertify, or which are invested in eligible entities, intended to be QOZBs, but that erroneously self-certified as QOFs on Form 8996, would be unable to avoid penalties through self-decertification that would otherwise continuously accrue under section 1400Z-2(f) from a QOF's failure to satisfy its ninety percent investment standard in QOZP during any taxable year from 2018 to 2022.²¹

Continuing to link the timing of a QOF's self-decertification to the effective date of IRS forms, instructions and other guidance establishing procedures for such decertification would have been fundamentally unfair in light of the federal government's failure to provide such procedures years after the Treasury Department and the IRS announced an intention to publish additional guidance regarding QOF decertification in the October 2018

²⁰ T.D. 9889, 86 Fed. Reg. 42715 (Aug. 5, 2021).

²¹ See *id.* (including changes to the Preamble on self-decertification of QOFs that removes the timing requirements previously required, which are applicable on or after January 13, 2020).

proposed regulations on Investing in Qualified Opportunity Funds.²² In the part of the Preamble to the final regulations under section 1400Z-2, released on December 17, 2019, that was left unchanged by the 2021 correcting amendments, the Treasury Department and IRS promised that they were “developing additional instructions regarding QOF self-decertification including instructions regarding the time, form, and manner of QOF self-decertification.”²³ The 2021 correcting amendments merely removed the pre-amendment rule on the timing of a QOF’s self-decertification election;²⁴ they did not replace it with any alternative timing rule so that opportunity zone funds and their investors are left to wonder whether a protective self-decertification filing may still be required to avoid penalties under whatever timing rule the IRS and Treasury Department eventually adopt when procedures for a QOF’s decertification are ultimately defined.²⁵

All this uncertainty over how taxpayers who have received tax relief under the QOZ Program give them up in exchange for penalties relief is surprising in light of the IRS’s apparent adoption of a check-the-box procedure on November 6, 2020, in a draft version of IRS Form 8996, together with draft Instructions for Form 8996, released two days earlier on November 4, 2020.²⁶ The draft instructions permitted QOFs to use the same form for voluntary decertification as they use for self-certifying as a QOF: namely, domestic partnerships and corporations that used Lines 1 through 4 of Form 8996 to certify the entity’s organizing documents establish their purpose of investing in QOZP of a trade or business in a QOZ would have used Line 6 of the November 2020 draft Form 8996 to voluntarily self-decertify as a QOF in order to avoid section 1400Z-2(f) penalties from a failed project in an opportunity zone.²⁷ Line 6 of Form 8996 is now “[r]eserved for future use,” which may suggest that voluntary QOF decertification will still be allowed on that line; but, if so, it is unclear why

²² See Investing in Qualified Opportunity Funds, 83 Fed. Reg. 54283 (September 29, 2018); see also T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1897 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (“In the October 2018 proposed regulations, the Treasury Department and the IRS announced an intention to publish additional guidance regarding QOF decertification. See 83 Fed. Reg. 54283 (Sept. 29, 2018). Comments were received on this topic, including comments requesting a mechanism to permit a QOF to self-decertify, as well as comments requesting guidance on the ability of the IRS to decertify a QOF.”).

²³ T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1897 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1).

²⁴ T.D. 9889, 86 Fed. Reg. 42716 (Aug. 5, 2021).

²⁵ The August 5, 2021, correcting amendments deleted the following language from the rule on self-decertification of a QOF: “The self-decertification becomes effective at the beginning of the month following the month specified by the taxpayer, which month must not be earlier than the month in which the taxpayer files its self-decertification . . .” See *id.*

²⁶ I.R.S. Draft Form 8996, Qualified Opportunity Fund, at *1 (Nov. 6, 2020); I.R.S. Draft Instructions for Form 8996, Qualified Opportunity Fund, at *4 (Nov. 4, 2020) (“Check this box [Line 6] only if you are electing to decertify as a QOF.”).

²⁷ *Id.*

the IRS retreated from the check-the-box self-decertification of QOFs adopted in the November 2020 draft form.²⁸

Moreover, whatever procedures are required by the IRS in future guidance to self-decertify a QOF pursuant to section 1.1400Z2(d)-1(a)(3) of the Treasury Regulations, promulgated on January 13, 2020, under section 1400Z-2 of the Internal Revenue Code of 1986, will apparently apply retroactively to QOFs that had been relying on the final regulations' provisions on the effective date of a QOF self-decertification election (including those that may have made protective filings on the basis of the timing rules for such decertification established in the section 1400Z-2 regulations published in the Federal Register on January 13, 2020).²⁹ Although the final regulations under section 1400Z-2, including the provisions permitting the self-decertification of entities as QOFs, are only generally effective for taxable years beginning after March 13, 2020 (including, for example, the 2021 tax year of calendar year taxpayers), taxpayers may rely on each of the respective sections of final regulations, including those applicable to self-certification and decertification of QOFs, in taxable years beginning after December 21, 2017, and on or before March 13, 2020, by applying the applicable section of the final regulations in a consistent manner to all such taxable years.³⁰

As set forth in this article, certain QOFs operating in sectors of the economy that have been adversely affected by the public health response to the outbreak of the 2019 novel coronavirus, known as "COVID-19," no longer have viable projects within low-income communities and contiguous tracts that have been designated as QOZs, within which at least ninety percent of such a fund's investments must be targeted to allow investors to receive federal income tax benefits under section 1400Z-2(a) through (c) and avoid penalties under section 1400Z-2(f). For these funds, self-decertification as a QOF may offer the most viable means of avoiding compounding penalties at the underpayment rate for federal income taxes, compounded monthly, for each year in which an entity that has self-certified as a QOF fails to maintain its ninety percent investment threshold in qualifying businesses and business property in a QOZ.³¹

IRS Form 8996's draft instructions, released on November 4, 2020, before they were withdrawn, may indicate that the IRS will allow QOFs to elect to decertify in a future version of that form (including, potentially, the

²⁸ *See id.*

²⁹ *See* T.D. 9889, 86 Fed. Reg. 42716 (Aug. 5, 2021) ("These corrections [to, inter alia, the QOF decertification rules] are effective on August 5, 2021 and applicable on or after January 13, 2020.") (emphasis added).

³⁰ Treas. Reg. § 1.1400Z2(d)-1(e)(2) (as amended in 2020).

³¹ *See generally* I.R.C. § 1400Z-2(f)(1) (providing for the calculation of penalties for failure by a QOF to invest ninety percent of its assets in QOZP).

2022 Form 8996).³² If the IRS resuscitates the model for voluntary decertification of QOFs used in the November 2020, draft Form 8996, it would allow funds for the first time to elect to decertify as QOFs by checking the appropriate box on Line 6 of the form and attaching a statement to the form, making this election and identifying the date of the fund's election to decertify as a QOF.³³ If applied retroactively, the IRS's adoption of a check-the-box approach to voluntary self-decertification of opportunity zone funds (as in the November 2020 draft instructions for Form 8996) would give QOFs invested in unviable projects a means of avoiding penalties that are imposed on funds for failing to maintain ninety percent of their assets in certain businesses and business property in a QOZ by making a self-decertification election under the section 1400Z-2 regulations. For some funds, which were required to protectively self-decertify as QOFs to meet the timing requirements under Treas. Reg. § 1.1400Z2(d)-1(a)(3), prior to its amendment, additional guidance is needed on the efficacy of filings notifying the IRS of an intention to self-decertify as a QOF during the more-than-two-year period since QOFs' voluntary decertification has been allowed under the section 1400Z-2 regulations, without any IRS forms, instructions or guidance to make that provision operative.³⁴

This article addresses the scope of, and need for, this guidance for self-certified investment vehicles that have elected to become QOFs to choose to decertify as QOFs, as well as several areas of outstanding guidance on the issue of decertifying QOFs that is still necessary.

II. BACKGROUND

A. The Qualified Opportunity Zone (QOZ) Program

Under sections 1400Z-1 and 1400Z-2 of the Internal Revenue Code of 1986, added by section 13823 of the Tax Cuts and Jobs Act, electing taxpayers realize benefits by investing in equity issued by a self-certified investment vehicle called a "qualified opportunity fund" (QOF) within 180 days of realizing certain types of "eligible gain."³⁵ In particular, section

³² I.R.S. Draft Instructions for Form 8996, Qualified Opportunity Fund, at *4 (Nov. 4, 2020).

³³ *Id.*

³⁴ See T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1978 (Jan. 13, 2020) (to be codified in C.F.R. pt. 1) ("If a QOF chooses to self-decertify as a QOF, . . . [t]he self-decertification must be effected 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 (see [Treas. Reg.] §§ 601.601(d)(2) (as amended in 2020) and 601.602 of this chapter).").

³⁵ See I.R.C. § 1400Z-2(a)(1)(A) (permitting a deferral election to be made, under circumstances, by investing in a QOF within 180 days of recognizing certain gain); Treas. Reg. § 1.1400Z2(a)-1(b)(1) (as amended in 2020) (defining "eligible gain" for purposes of making a deferral election under section 1400Z-2(a)(1)(A)).

1400Z-2(a)(1)(A) allows taxpayers to elect the tax deferral and reduction benefits of section 1400Z-2 with respect to “gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer” to the extent that a corresponding amount is timely invested in a QOF. Treasury Regulations under section 1400Z-2 define gain that is eligible to be deferred under section 1400Z-2(a)(1)(A) from a timely investment in a QOF—or “eligible gain”—as any amount of gain if:

(1) the gain is either a capital gain for federal income tax purposes (including, for this purpose, short-term capital gain, long-term capital gain, collectibles gain, unrecaptured section 1250 gain, and net gain during the taxable year from contracts marked to market under section 1256), or a qualified section 1231 gain from the sale of depreciable or real property used in a trade or business and held for more than one year, not taking into account any losses, but otherwise taking into any other Code provisions that require the potential capital gain to be treated as ordinary income;

(2) the gain would be recognized by the taxpayer for federal income tax purposes and would be subject to tax under subtitle A of the Code before January 1, 2027, if section 1400Z-2(a)(1)(A) did not apply to defer such recognition; and

(3) the gain does not arise from a sale or exchange with a person related to either (1) the eligible taxpayer that would recognize the gain in the taxable year in which the sale or exchange occurs if there was no deferral election under section 1400Z-2, or (2) any passthrough entity (including an entity taxable as a partnership, Subchapter S corporation (“S corporation”) for federal income tax purposes or any trust or estate) recognizing and allocating the gain to such an eligible taxpayer.³⁶

For this purpose, an eligible taxpayer includes any person that is required to report the recognition of capital gains during the tax year for federal income tax accounting purposes, such as an individual, partnership, S corporation, C corporation (including a regulated investment company (RIC) or real estate investment trust (REIT)), non-grantor trust, or estate, and tax-exempt organizations and state colleges and universities subject to tax on unrelated business taxable income under Code section 511, and, for purposes of the related-party rule, a modified twenty percent definition of a related person in section 1400Z-2(e)(2) applies.³⁷ Under this rule, a person is a “related person” with respect to any taxpayer if there is a relationship described in one of the categories under sections 267(b) and 707(b)(1) of the

³⁶ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(i) (as amended in 2020).

³⁷ Treas. Reg. § 1.1400Z2(a)-1(b)(13) (as amended in 2020) (defining an “eligible taxpayer” for purposes of making a deferral election under section 1400Z-2(a)(1)(A) of the Code).

Code, determined by substituting “20 percent” for “50 percent” each place it occurs in such subsections,³⁸ including: (1) an individual’s siblings, spouse, ancestors, and lineal descendants;³⁹ (2) a partnership and a person owning more than twenty percent of the capital or profits interest in the partnerships;⁴⁰ (3) two partnerships in which the same person owns more than twenty percent of the capital or profits interest;⁴¹ (4) a corporation and an individual shareholder who owns more than twenty percent of the value of the stock;⁴² (5) a parent-subsidiary controlled group of two or more corporations involving a chain of corporations in which the common parent corporation owns more than twenty percent of the voting power and value of the stock of one corporation, and one of the other corporations owns more than twenty percent of the voting power or value of another corporation;⁴³ (6) a brother-sister controlled group of two or more corporations in which five or fewer persons (individuals, estates, or trusts) own more than fifty percent of the voting power or more than fifty percent of the value of each corporation (taking into account identical stock ownership with respect to each corporation);⁴⁴ (7) a grantor and a fiduciary of any trust;⁴⁵ (8) fiduciaries of different trusts (if one person is the grantor of both trusts);⁴⁶ (9) a fiduciary of a trust and a beneficiary of that trust;⁴⁷ (10) a fiduciary of a trust and a beneficiary of another trust (if the same person is grantor of both trusts);⁴⁸ (11) a corporation and a fiduciary of a trust that owns more than twenty percent of the value of the stock (or the trust’s grantor owns more than twenty percent of the value);⁴⁹ (12) a tax-exempt organization and a person or individual (or the individual’s family) who controls the organization;⁵⁰ (13) a corporation and a partnership if the same person owns more than twenty percent of the value of the stock and more than twenty percent of the capital

³⁸ I.R.C. § 1400Z-2(e)(2).

³⁹ I.R.C. § 267(b)(1).

⁴⁰ I.R.C. § 707(b)(1)(A), *modified* I.R.C. § 1400Z-2(e)(2).

⁴¹ I.R.C. § 707(b)(1)(B), *modified* I.R.C. § 1400Z-2(e)(2).

⁴² I.R.C. § 267(b)(2), *modified* I.R.C. § 1400Z-2(e)(2).

⁴³ I.R.C. § 1563(a)(1), *modified* I.R.C. §§ 267(b)(3), (f)(1), *modified* I.R.C. § 1400Z-2(e)(2); Treas. Reg. § 1.1400Z2(a)-1(b)(39) (as amended in 2020).

⁴⁴ Note that due to a potential drafting error, I.R.C. § 1400Z-2(e)(2) requires substituting “more than 20 percent” for “more than 50 percent” in the “controlled group” definition under I.R.C. § 267(f)(1)(A), which, in turn, substitutes “more than 20 percent” for “*at least 80 percent*” stock ownership requirements in the parent-subsidiary controlled group definition under I.R.C. § 1563(a)(1), but has no effect on lowering the “more than 50 percent” stock ownership requirement for a brother-sister controlled group in I.R.C. § 1563(a)(2). *See* I.R.C. § 1563(a)(2), *modified* I.R.C. § 267(f)(1), *modified* I.R.C. § 1400Z-2(e)(2); Treas. Reg. § 1.1400Z2(a)-1(b)(39) (as amended in 2020).

⁴⁵ I.R.C. § 267(b)(4).

⁴⁶ I.R.C. § 267(b)(5).

⁴⁷ I.R.C. § 267(b)(6).

⁴⁸ I.R.C. § 267(b)(7).

⁴⁹ I.R.C. § 267(b)(8), *modified* I.R.C. § 1400Z-2(e)(2).

⁵⁰ I.R.C. § 267(b)(9).

or profits interest in the partnership;⁵¹ (14) two or more S corporations owned more than twenty percent (by value) by the same person;⁵² (15) an S corporation and a C corporation if the same person owns more than twenty percent of the value of each;⁵³ and (16) an executor and a beneficiary of an estate (except in the case of a sale to satisfy a pecuniary bequest).⁵⁴ The definition of “eligible gain” also includes gain realized from certain straddles, as defined in section 1092(a), with certain exceptions applicable to identified straddles, mixed straddles and mixed straddle accounts.⁵⁵

The purpose of section 1400Z-2 is to provide federal income tax benefits to owners of QOFs to encourage new, long-term capital investments, through QOFs, in one or more QOZs and to increase the economic growth of such QOZs.⁵⁶ Only taxpayers who elect to roll over certain capital gains realized before December 31, 2026 will be able to take advantage of the special treatment of gains realized both before and after the QOF investment under the QOZ provisions.⁵⁷

To obtain the tax benefits of an investment in a QOF, the taxpayer must reinvest some or all of its eligible gain into a “qualified opportunity fund” (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) to defer the gain invested in the QOF (the “deferred gain”).⁵⁸ An eligible taxpayer uses Form 8949, *Sales and Other Dispositions of Capital Assets*, to make this election on its timely-filed federal income tax return (including extensions) for the tax year in which the eligible gain would have been included if not deferred (the “deferral election”).⁵⁹ In addition, taxpayers that hold a QOF investment at any time during the tax year must file 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

⁵¹ I.R.C. § 267(b)(10)(A)-(B), *modified* I.R.C. § 1400Z-2(e)(2).

⁵² I.R.C. § 267(b)(11), *modified* I.R.C. § 1400Z-2(e)(2).

⁵³ I.R.C. § 267(b)(12), *modified* I.R.C. § 1400Z-2(e)(2).

⁵⁴ I.R.C. § 267(b)(13).

⁵⁵ Treas. Reg. § 1.1400Z2(a)-1(b)(11)(vi)(C) (as amended in 2020) (providing, under certain circumstances, for the deferral of capital gains attributable to positions that were part of an identified straddle under I.R.C. § 1092(a)(2) or I.R.C. § 1256(d) or an identified mixed straddle under Treas. Reg. § 1.1092(b)-3T (as amended in 2014), or were included in a mixed straddle account under Treas. Reg. § 1.1092(b)-4T (1985)).

⁵⁶ Treas. Reg. § 1.1400Z2(f)-1(c)(1) (as amended in 2020).

⁵⁷ H.R. REP. NO. 115-466 (2017) (Conf. Rep.); Tax Cuts and Jobs Act, Pub. L. No. 115-97 (2017).

⁵⁸ Treas. Reg. § 1.1400Z2(a)-1(a) (as amended in 2020).

⁵⁹ Treas. Reg. § 1.1400Z2(a)-1(a)(2) (as amended in 2020); I.R.S. Instructions to Form 8949, at *9-10 (2019).

included in gross income for the applicable year, which may be rebutted by the taxpayer filing the delinquent statement.⁶⁰

For a taxpayer with eligible gain to elect deferral and receive the tax benefits associated with a qualifying investment in a QOZ discussed below, the eligible taxpayer that realizes such gain must invest such gain in a QOF, as defined by section 1400Z-2(d) of the Code and regulations thereunder, within a 180-day period, generally beginning on the date on which the gain would have been recognized by the taxpayer if a deferral election under section 1400Z-2(a)(1)(A) had not been made to defer recognition of such gain for federal income tax purposes.⁶¹

B. What is a Qualified Opportunity Fund, or “QOF”?

A qualified opportunity fund, or “QOF,” is any self-certified investment vehicle that is organized as a corporation or partnership for federal income tax purposes to invest in “qualified opportunity zone property” (other than another QOF) that holds at least ninety percent of its assets in such property.⁶² For this purpose, “qualified opportunity zone property,” or “QOZP,” means a direct investment by a QOF in tangible property of a trade or business in a QOZ, known as “qualified opportunity zone business property” (QOZBP), or a qualifying ownership interest in a “qualified opportunity zone business” (QOZB), known as “qualified opportunity zone partnership interests” (“QOZ partnership interests”) or “qualified opportunity zone stock” (“QOZ stock”), as applicable, for businesses organized respectively as partnerships or corporations for federal income tax purposes.⁶³

To be eligible to be a QOF, the entity must be organized under the laws of one of the fifty states, a federally-recognized Native American tribe, the District of Columbia, or a U.S. possession where a QOZ has been designated, provided that an entity organized under the laws of a U.S. possession is only eligible to be a QOF if it is organized for the purpose of investing in QOZP that relates to a trade or business operated in the U.S. possession in which the entity is organized.⁶⁴ The QOF must hold at least ninety percent of its assets in QOZP (the “ninety percent investment standard”), determined by the

⁶⁰ Treas. Reg. § 1.1400Z2(a)-1(d)(2) (as amended in 2020); I.R.S. Instructions to Form 8997, at *3 (2019).

⁶¹ I.R.C. § 1400Z-2(a)(1)(A); Treas. Reg. § 1.1400Z2(a)-1(b)(7)(i) (as amended in 2020) (providing the general rule that, unless otherwise provided, the term “180-day period” means the 180-day period for investing in a QOF referred to in section 1400Z-2(a)(1)(A) “that begins on 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 and the section 1400Z-2 regulations to defer recognition of that gain”).

⁶² Treas. Reg. § 1.1400Z2(d)-1(a)(1) (as amended in 2020).

⁶³ I.R.C. § 1400Z-2(d)(2).

⁶⁴ See Treas. Reg. § 1.1400Z2(d)-1(a)(1)(ii)(B) (as amended in 2020) (restricting QOFs organized in possessions to those operating a trade or business, directly or indirectly, in American Samoa, Guam, Puerto Rico, the Northern Mariana Islands or the U.S. Virgin Islands).

average percentage of QOZP in the fund as of specified testing dates. The first testing date is measured on the last day of the first 6-month period of the taxable year of the fund or the last day of the taxable year of the fund, whichever is earlier (each, a “semiannual testing date”).⁶⁵ A calendar year QOF will have testing dates on June 30 and December 31 every year after its first taxable year.⁶⁶ A QOF must elect to become a QOF on the initial Form 8996, Qualified Opportunity Fund, filed with a timely-filed (including extensions) federal income tax return 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, the QOF must annually complete a Form 8996 filed with a timely federal income tax return (including extensions) to either certify its compliance with the ninety percent 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 IRC § 6621(a)(1), computed quarterly by the IRS.⁶⁷

C. Tax Benefits from QOF Investments

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.⁶⁸ If held for five years, ten percent of the taxpayer’s realized gain is permanently excluded from taxable income for federal income tax purposes.⁶⁹ If the investment is held for seven years, a total of fifteen percent of the taxpayer’s realized gain is permanently excluded (including ten percent excluded after five years, plus an additional five percent on the seventh anniversary of the QOF investment).⁷⁰

Further, if the investment is held for at least ten years and is sold or exchanged before January 1, 2048, not only is fifteen percent of the taxpayer’s realized gain permanently excluded, but so too is the post-acquisition gain from a basis step-up of the QOF investment to its fair market

⁶⁵ Treas. Reg. § 1.1400Z2(d)-1(a)(2)(iv)(A) (as amended in 2020) (“[T]he phrase first six-month period of the taxable year of the fund means the first six months each of which is in the taxable year and in each of which the entity is a QOF. Thus, if an eligible entity becomes a QOF in the seventh or later month of a 12-month taxable year, the ninety percent investment standard in section 1400Z-2(d)(1) takes into account only the QOF’s assets on the last day of the QOF’s taxable year.”).

⁶⁶ I.R.C. § 1400Z-2(d)(1).

⁶⁷ See I.R.C. § 1400Z-2(f); I.R.S., Instructions to Form 8996 (Jan. 2020).

⁶⁸ I.R.C. § 1400Z-2(b)(1). For inclusion events, see Treas. Reg. § 1.1400Z2(b)-1(c) (providing general rules applicable to all taxpayers). For special rules on inclusion events applicable to consolidated groups, see Treas. Reg. Treas. Reg. § 1.1502-14Z(b)(1)(i), (c)(3) and (g)(2), and Treas. Reg. § 1.1504-3(b)(2)(ii).

⁶⁹ I.R.C. § 1400Z-2(b)(2)(B)(iii).

⁷⁰ I.R.C. § 1400Z-2(b)(2)(B)(iv).

value (“FMV”), including inventory, at the time the QOF investment is sold, exchanged or otherwise disposed of in a pre-2048 transaction.⁷¹ Moreover, the final regulations provide a gross income exclusion for eligible taxpayers who hold a qualifying investment in a QOF partnership or QOF S corporation for at least ten years, under which a taxpayer may elect to exclude from gross income their distributive share of all gains and losses from all sales or exchanges of noninventory property by the QOF or any of its QOZBs or other partnership(s) owned directly or indirectly through one or more partnerships by the QOF, as reported on Schedule K-1 of the QOF.⁷² However, if at any time before December 31, 2026, the taxpayer sells, exchanges, or otherwise disposes of its interest in the QOF, all remaining gains deferred pursuant to the QOF investment, not otherwise reduced by basis step-ups on the fifth and seventh anniversaries of the taxpayer’s investment, as well as any post-acquisition appreciation in the value of that investment, will be recognized in gross income in the taxable year in which the sale, exchange or other disposition of the interest in the QOF takes place.⁷³

The following provides an example of the preferential tax treatment available, under certain circumstances, to eligible taxpayers that elect to defer gain from an investment in an eligible interest of a self-certified QOF.⁷⁴

Example 1. Investment in a Self-Certified QOF. On September 1, 2018, Taxpayer A triggers a \$100,000 capital gain from the sale of stock to an unrelated party (\$200,000 proceeds less \$100,000 tax basis). On February 15, 2019, Taxpayer A invests \$100,000 into a QOF, which uses these proceeds to acquire QOZP. Taxpayer A elects on IRS Form 8949, Sales and Other Dispositions of Capital Assets, timely filed with its federal income tax return for 2018, to defer the \$100,000 capital gain recognized on September 1, 2018, in accordance with the instructions to Form 8949.⁷⁵ Beginning in 2019, Taxpayer A also uses Form 8997, Initial and Annual Statement of Qualified

⁷¹ Treas. Reg. § 1.1400Z2(c)-1(b)(3)(i) (as amended in 2020). However, if the taxpayer’s interest in the QOF has declined in value, the investor will simply not elect the FMV basis under IRC § 1400Z-2(c) and sell the QOF investment for a loss.

⁷² Treas. Reg. § 1.1400Z2(c)-1(b)(2)(ii)(A) (as amended in 2020).

⁷³ I.R.C. § 1400Z-2(b)(1)(A).

⁷⁴ Note that none of these benefits are available with respect to investments made by taxpayers in an otherwise eligible entity before or after the time period in which that entity elects to be treated as a QOF. *See* Treas. Reg. § 1.1400Z2(d)-1(a)(2)(iii)(B).

⁷⁵ These instructions generally require the taxpayer to report the deferral of eligible gain on its own row of Form 8949 in Part I with box C checked in the case of a short-term capital gain or Part II with box F in the case of long-term capital gain. In the applicable part, the eligible taxpayer reports the EIN of the QOF into which the investment was made in column (a), the date of the investment in column (b), code “Z” in column (f), and the amount of the deferred gain as a negative number in column (g). *See* I.R.S. 2021 Instructions for Form 8949, Sales and Other Dispositions of Capital Assets, at *11 (Jan. 7, 2022). Special rules apply, however, in the case of reporting section 1231 gains, which must also be deferred in accordance with the instructions for Form 4797. *See* I.R.S. 2021 Instructions for Form 4797; *see also* Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)), at *4 (Sept. 15, 2021).

Opportunity Fund (QOF) Investments, to inform the IRS of the QOF investments and deferred gains held at the beginning and end of the taxpayer's current tax year, as well as any capital gains deferred by investing in a QOF and QOF investments disposed of during the current tax year.⁷⁶

Taxpayer A holds its \$100,000 investment in the QOF until at least February 15, 2029, but not later than December 31, 2047, at which time Taxpayer A's sale or exchange of this QOF investment is eligible for a second election that will allow Taxpayer A to step-up its basis in the QOF investment to FMV 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.⁷⁷ Assume at the time Taxpayer A sells its interest in the QOF or a qualifying QOF passthrough investment, the initial \$100,000 investment has appreciated in value to \$500,000, and all that gain from the sale or exchange of the investment would have otherwise been taxed as a long-term capital gain at an effective tax rate of 23.8 percent (including a twenty percent long-term capital gains tax under I.R.C. § 1(h)(1)(D) and a 2.3 percent net investment income tax ("NIIT") under I.R.C. § 1411).

Based on these assumptions, the following table reflects Taxpayer A's tax deferral and reduction benefits resulting from the QOF investment over ten years.

⁷⁶ Even if Taxpayer A's investment in the QOF had been made in 2018, the taxpayer would not have had a filing obligation with respect to IRS Form 8997 until 2019, which is the year when that form was first promulgated by the IRS. *See* I.R.S. Form 8997, OMB No. 1545-0123 (2019).

⁷⁷ *See* I.R.C. § 1400Z-2(c). For the rule permitting an election under section 1400Z-2(c) until December 31, 2047, *see* Treas. Reg. § 1.1400Z2(c)-1(c) ("The ability to make an election under section 1400Z-2(c) for investments held for at least ten years is not impaired solely because, under section 1400Z-1(f), the designation of one or more qualified opportunity zones ceases to be in effect. The preceding sentence does not apply to elections under section 1400Z-2(c) that are related to dispositions occurring after December 31, 2047.").

Election #1 Front End Benefit – Capital Gain Deferral and Basis Step-Up				
2018	2024	2026	12/31/2026	2029 to 2047
Defer paying tax of \$23,800 (\$100,000 x 23.8%, based on presumed capital gains rate of 20%, plus 3.8% NIIT)	\$2,380 (10% of tax forgiven at 5-year holding period by virtue of \$10,000 basis step-up	\$1,190 (5% of tax forgiven at 7-year holding period by virtue of \$5,000 basis step-up	Regardless of holding period, taxpayer must pay \$20,230 on deferred gain (effectively 17% capital gains tax rate, plus 3.23% NIIT, or 20.23%)	
\$0	\$0	\$0	\$20,230	

Election #2 Back End Benefit – Gain Exclusion and Basis Step-Ups				
2019	2024	2026	12/31/2026	2029 to 2047
\$100,000 investment in QOF made within 180-days = zero outside basis in QOF	\$10,000 QOF outside tax basis increase	\$5,000 QOF outside tax basis increase	\$85,000 QOF outside tax basis increase	QOF investor makes FMV basis step-up election, excluding from the taxpayer's income all \$400,000 in gain arising from such QOF investment's disposition. Investor avoids paying 2029 tax of \$95,200 (\$400,000 x 23.8% = 20% long-term capital gains tax rate, plus 3.8% NIIT)
Total Tax Paid by Taxpayer A with QOF Investment				
None	None	None	\$20,230	None

Total Tax Payable by Taxpayer A without QOF Investment				
\$23,800	None	None	None	\$95,200

As described above, Taxpayer A's total tax cost outside of the QOZ program would be \$119,000 on total long-term capital gains of \$500,000, \$23,800 of which would have been taxed on 2018 income, payable in 2019, with the remaining \$95,200 taxed on the disposition of the QOF investment, occurring between 2029 and 2047. By comparison, the QOZ program limits the taxpayer's entire tax cost from the aggregate gain of \$500,000 to \$20,230,

or seventeen percent of the tax that would otherwise have been due and owing to the IRS. Moreover, all of that \$20,230 in federal tax on ninety percent of Taxpayer A's initial \$100,000 of long-term capital gain realized in 2018 is not payable until 2027, eight years after it would otherwise have been owed to the IRS, an important consideration in today's inflationary environment.

D. The Need for Guidance on Decertification of QOFs

Taxpayers that invest, through QOFs, in virtually any trade or business in one of 8,764 population census tracts that have been designated QOZs may elect (on Form 8949) to defer until 2026, including in income amounts attributable to capital gains or section 1231 gains realized from unrelated persons within the 180 days ending on and including the date of the investment in equity issued by a QOF.⁷⁸ The taxpayer's temporary deferral period may end early, however, if the QOF investment is sold before December 31, 2026, or another inclusion event occurs, including, without limitation, the self-decertification of the QOF.⁷⁹ In addition, while tax-deferred investors start off with a zero-dollar basis in the QOF, to preserve the gain previously recognized and rolled over into the fund, they realize basis increases of ten percent and fifteen percent on the fifth and seventh anniversaries of investing in the QOF, provided that such anniversaries are reached before the mandatory end of the temporary deferral period on December 31, 2026.⁸⁰ (Thus, only taxpayers that have been invested in a QOF since December 31, 2019, are eligible for the fifteen percent basis increase.)⁸¹ These basis boosts effectively eliminate eligible gain that would otherwise have been included in gross income in the year in which it was realized when the deferred gain is ultimately recognized no later than December 31, 2026.⁸² Finally, in the QOZ Program's coup de gras, taxpayers that hold their investments in a QOF for at least ten years can dispose of their interest in the fund tax-free, as well as most property held directly or indirectly by such fund (except for inventory), thus eliminating all post-

⁷⁸ I.R.C. § 1400Z-2(a)(1)(A) (providing the general rule with respect to the deferral of gains not required to be included by I.R.C. § 1400Z-2(b)); I.R.C. § 1400Z-2(b)(1)(B) (providing the mandatory end of the temporary deferral period as December 31, 2026).

⁷⁹ Treas. Reg. § 1.1400Z2(b)-1(b) (as amended in 2020) (providing the general rule that the gain to which a deferral election applies is included in gross income as of earlier of (a) December 31, 2026, or (b) the date of any inclusion event); Treas. Reg. § 1.1400Z2(b)-1(c)(15) ("The decertification of a QOF, whether a self-decertification pursuant to [Treas. Reg.] § 1.1400Z2(d)-1(a)(3) or an involuntary decertification pursuant to [Treas. Reg.] § 1.1400Z2(d)-1(a)(4) [reserved], is an inclusion event.") (emphasis added).

⁸⁰ See I.R.C. § 1400Z-2(b)(1)(B); I.R.C. § 1400Z-2(b)(2)(B)(iii); I.R.C. § 1400Z-2(b)(2)(B)(iv).

⁸¹ See I.R.C. § 1400Z-2(b)(1)(B) (providing that December 31, 2026, is the last day of temporary deferral); I.R.C. § 1400Z-2(b)(2)(B)(iv) (requiring seven years' holding period in a QOF before the end of the temporary deferral period in order to qualify for the fifteen percent basis step-up).

⁸² See I.R.C. § 1400Z-2(b)(2)(B)(iii); I.R.C. § 1400Z-2(b)(2)(B)(iv).

acquisition appreciation in the value of the QOF investment from day one of the investment from the federal income tax base.⁸³ Under Treasury Regulations proposed in October 2018, modified in April 2019, and finalized in January 2020, taxpayers can realize such tax-free appreciation through December 31, 2047, if they continue to hold their investments in the QOF until that date.⁸⁴

In the current environment, many taxpayers that were eager to invest in QOFs planning to develop, through QOZBs, a trade or business in a lower-income census tract designated as an opportunity zone, have been forced to reconsider their business plans. For example, some QOFs that had planned large-scale, long-term developments in the hospitality industry have been forced to amend their development timeline, which has been facilitated by IRS Notice 2020-39 and IRS Notice 2021-10, issued in order to postpone various deadlines for QOFs and their investors in the wake of the COVID-19 pandemic.⁸⁵ Notice 2020-39, as modified by Notice 2021-10, provided a blanket safe harbor from penalties for QOFs that failed to satisfy the ninety percent investment standard in 2020 and 2021.⁸⁶ But, invariably, other QOFs have seen their business prospects dwindle so that they lack a viable project within a QOZ census tract into which their investors' capital may flow. Because of the requirement that QOFs invest ninety percent of their assets in QOZP, QOFs that no longer have a viable investment in a QOZ may be subject to significant penalties in 2022 under I.R.C. § 1400Z-2(f) now that the relief provided under Notices 2020-39 and 2021-10 during the COVID-19 pandemic is no longer available.⁸⁷ As set forth in the IRS Instructions to Form 8996, the penalty under section 1400Z-2(f)(1) that applies if the QOF fails to hold ninety percent of its assets in QOZP, based on the average value of such

⁸³ I.R.C. § 1400Z-2(c) (providing, in the case of any investment in a QOF held by a taxpayer for ten years, a special election that increases the basis of the QOF investment to fair market value at the time the investment is sold or exchanged); Treas. Reg. § 1.1400Z2(c)-1(b)(2) (providing special rules with respect to QOF partnerships and S corporations whereby their respective partners and stockholders may elect to exclude gains and losses recognized directly or indirectly by the QOF for a taxable year after the QOF investor reaches the ten-year holding period).

⁸⁴ Treas. Reg. § 1.1400Z2(c)-1(c) (as amended in 2020).

⁸⁵ I.R.S. Notice 2020-39, 2020-26 I.R.B. 984 (Jun. 22, 2022); I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021).

⁸⁶ Notice 2020-39, 2020-26 I.R.B. 984, Part III.B (Jun. 22, 2020) (deeming a failure of a QOF to hold ninety percent of its assets in QOZP during 2020 as due to reasonable cause, exempt from penalties under section 1400Z-2(f) by virtue of section 1400Z-2(f)(3), provided that the QOF had a semiannual testing date ending within the period beginning on April 1, 2020, and ending on December 31, 2020); Notice 2021-10, 2021-7 I.R.B. 888, Part IV.A (Feb. 16, 2021) (extending the penalties relief provided in Notice 2020-39 to any QOF whose (i) last day of the first 6-month period of its taxable year, or (ii) last day of its taxable year falls within the period from April 1, 2020 through June 30, 2021).

⁸⁷ See generally Notice 2021-10, 2021-7 I.R.B. 888, Part IV.A (Feb. 16, 2021) (limiting relief from penalties under section 1400Z-2(f) to QOFs whose semiannual testing date falls between April 1, 2020 and June 30, 2021).

property, as a proportion of all assets held on semiannual testing dates, is essentially equal to the shortfall below that ninety percent threshold each month multiplied by the federal tax underpayment rate for such month.⁸⁸ If a QOF has no means of investing in QOZP, that penalty will accrue at the underpayment rate multiplied by ninety percent of the QOF's invested capital.⁸⁹

This changed, post-pandemic, economic environment facing QOFs and QOZBs makes the provision in the final regulations under section 1400Z-2 that allows for voluntary self-decertification of QOFs particularly important today.⁹⁰ The regulations allow any QOF to elect to decertify as a QOF.⁹¹ The revocation of a QOF election, whether voluntary or involuntary, is an inclusion event with respect to the fund's investors if it occurs before the end of the temporary deferral period for previously recognized gains, currently set for December 31, 2026.⁹² The QOF's voluntary or involuntary decertification terminates the qualifying investment status of the taxpayer's interest in the QOF.⁹³

Example 2. Decertification of Qualified Opportunity Fund. On May 31, 2019, taxpayer A sells a capital asset to an unrelated party and realizes \$500 of capital gain. On October 31, 2019, A transfers \$500 to newly formed Q, a QOF corporation, in exchange for a qualifying investment. On February 28, 2021, Q elects to decertify as a QOF, and the decertification becomes effective on April 1, 2021, at a time when the fair market value of A's qualifying investment in Q is \$800.

On the facts above, taxpayer A made a qualifying investment of \$500 on October 31, 2019, by transferring cash to QOF Q.⁹⁴ As a result of Q's decertification election, A is treated solely for purposes of the QOZ program

⁸⁸ I.R.S. Instructions for Form 8996, at *5–6 (Dec. 2021) (providing instructions for computing penalties owed under Part IV of Form 8996 for QOFs that fail the ninety percent investment standard, determined in Part III of that form).

⁸⁹ See I.R.C. § 1400Z-2(f)(1) (providing the mechanism for calculating the QOF penalty for failure of the ninety percent investment standard). See also I.R.S. Instructions for Form 8996, at *5–6 (Dec. 2021).

⁹⁰ See generally 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. 19585, 19590 (Apr. 14, 2021) (“After the major disaster declarations issued in response to the ongoing novel coronavirus 2019 (COVID–19), . . . commenters pointed out, the post-disaster environment facing the qualified opportunity zone business may render the original plan suboptimal or even infeasible.”). pandemic,

⁹¹ Treas. Reg. § 1.1400Z2(d)-1(a)(3) (as amended in 2020).

⁹² Treas. Reg. § 1.1400Z2(b)-1(c)(15) (as amended in 2020).

⁹³ See Treas. Reg. § 1.1400Z2(b)-1(b) (as amended in 2020) (requiring the inclusion in gross income of the gain to which a deferral election relates on the date of an inclusion event); Treas. Reg. § 1.1400Z2(b)-1(c)(15) (defining QOF decertification as an inclusion event for all eligible taxpayers that deferred gain by investing in that QOF).

⁹⁴ Treas. Reg. § 1.1400Z2(a)-1(c)(6)(ii)(A) (2020).

as having an inclusion event with respect to 100 percent of her qualifying investment for federal income tax purposes on April 1, 2021, since that is the date on which the QOF in which the eligible taxpayer held a qualifying investment loses its status as a QOF.⁹⁵ Under the QOZ regulations, A's total amount of gain that is required to be included in gross income as a result of the inclusion event is limited to the amount of gain deferred under section 1400Z-2(a)(1)(A) of the Code (that is, \$500), even though her qualifying investment has appreciated in value since it was acquired.⁹⁶ Therefore, on April 1, 2021, A is required to recognize \$500 of capital gain, although that gain may be deferred and potentially reduced if A acquires a new interest in a QOF of up to \$500 during the 180-day period, beginning on April 1, 2021, and ending on September 27, 2021.⁹⁷

Note that prior to the 2021 correcting amendments, released on August 5, 2021, but effective on and after January 13, 2020, the self-decertification regulation provided that the election by a QOF to decertify as such becomes effective at the beginning of the month following the month that the QOF makes this election.⁹⁸ In addition, the regulation provided that the QOF could not elect to decertify as such in a month earlier than the month in which the taxpayer filed its self-decertification election.⁹⁹ For example, if an eligible entity that elected QOF status on December 1, 2019, subsequently elects to decertify on July 1, 2020, under the final regulations in effect prior to the 2021 correcting amendments, the decertification would become effective and the investors would have an inclusion event on August 1, 2020.¹⁰⁰ The 2021 correcting amendments removed this timing rule, making it unclear when taxpayers invest in a QOF that decertifies before December 31, 2026, recognize income from an inclusion event and start their 180-day period for making an investment in a new QOF to defer the included gain.¹⁰¹

While taxpayers that have invested in a QOF that decertifies may be required to include previously deferred gains in gross income in the year in which the QOF's decertification becomes effective, such decertification is valuable for two reasons. First, QOF investors in a fund that decertifies can avoid including their deferred capital gain and section 1231 gain by

⁹⁵ Treas. Reg. § 1.1400Z2(b)-1(c)(1)(iv) (as amended in 2020) (defining as an inclusion event, an event in which a QOF in which a taxpayer holds a qualifying investment loses its status as a QOF”).

⁹⁶ See Treas. Reg. § 1.1400Z2(b)-1(e)(5) (as amended in 2020) (“The total amount of gain included in gross income under [Treas. Reg. § 1.1400Z2(b)-1](e) is limited to the amount deferred under section 1400Z-2(a)(1) and the section 1400Z-2 regulations, reduced by any increase in the basis of the qualifying investment made pursuant to section 1400Z-2(b)(2)(B)(iii) and (iv).”).

⁹⁷ See Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(B) (2020) (“The 180-day period for investing gain from an inclusion event begins on the date of the inclusion event.”).

⁹⁸ See T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1978 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1).

⁹⁹ See *id.*

¹⁰⁰ See I.R.S., Draft Instructions for Form 8996, at *4 (Nov. 4, 2020).

¹⁰¹ Treas. Reg. § 1.1400Z2(d)-1(a)(3) (as amended by T.D. 9889, 86 Fed. Reg. 42716 (Aug. 5, 2021)).

reinvesting an amount equivalent to their qualifying investment in the now-decertified QOF in another corporation or partnership that is a self-certified QOF within 180 days of the former QOF's decertification.¹⁰² Second, those investors avoid penalties from the decertified QOF for months following the decertification of the fund as a QOF that would otherwise accrue if the entity were not able to acquire QOZ Property sufficient to equal ninety percent of its invested capital.¹⁰³

In November 2020, the IRS released a new draft Form 8996, together with instructions, that gave a QOF the option of checking a box on Line 6 of the form to elect to decertify as a QOF.¹⁰⁴ The election was voluntary and required a statement to be attached to Form 8996, making the election and providing the date of the QOF decertification.¹⁰⁵ In addition, the IRS released draft Instructions for Form 8996 that provided an example of how the timing of that self-decertification would work.¹⁰⁶ The following is an example of how Part 1 of Form 8996 might have been prepared under the November 2020 draft form's voluntary check-the-box system for QOF decertification.

Example 3. Check-the-box Decertification under November 2020 Draft Form 8996 (Line 6).

On December 1, 2018, taxpayers A and B each contribute \$100x of eligible gain (\$200x total) to XYZ QOF LLC, a partnership, in exchange for a qualifying QOF partnership interest in XYZ QOF LLC. On January 1, 2019, XYZ QOF LLC purchased a hotel on land within a QOZ for \$100x, with \$75x of the purchase price allocated to the building and \$25x allocated to the land. Over the next 30 months, XYZ QOF LLC planned to substantially improve the hotel at a cost of \$100x, of which \$80x had been spent by December 31, 2019. When COVID-19 struck the United States, however, XYZ QOF LLC's hotel project became unprofitable. If the IRS had retained the draft Form 8996 from November 2020, XYZ QOF LLC would have had the option (no longer available) to have checked the box on Line 6 of the form to decertify as a QOF on December 1, 2020, which would have become effective on January 1, 2021. The following is a sample of what such a self-decertification election might have looked like.

¹⁰² See Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(B) ("The 180-day period for investing gain from an inclusion event begins on the date of the inclusion event."); Treas. Reg. § 1.1400Z2(b)-1(c)(15) (as amended in 2020) ("The decertification of a QOF . . . is an inclusion event.")

¹⁰³ See generally I.R.S. Instructions for Form 8996, at *5-6 (Dec. 2021) (providing, in Example 6, that if an entity was not a QOF for a specified portion of the taxable year, the penalty in Part IV does not include those months for which the entity was not a QOF).

¹⁰⁴ I.R.S., Draft Form 8996, at *1 (Nov. 6, 2020).

¹⁰⁵ *Id.*

¹⁰⁶ I.R.S., Draft Instructions for Form 8996, at *4 (Nov. 4, 2020) ("The election to decertify becomes effective on the first day of the month after the month in which the QOF elects to decertify as a QOF. For example, if an entity elects to decertify on July 1, the decertification becomes effective on August 1.")

Form 8996 (Rev. December 2020) Department of the Treasury Internal Revenue Service	Qualified Opportunity Fund ▶ Go to www.irs.gov/Form8996 for instructions and the latest information. ▶ Attach to your tax return. See instructions.	OMB No. 1545-0123 Attachment Sequence No. 996
Name XYZ QOF LLC		Employer identification number 11-2222222
Part I General Information, Certification, and Decertification		
1 Type of taxpayer: <input type="checkbox"/> Corporation <input checked="" type="checkbox"/> Partnership		
2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone (QOZ) property (other than another qualified opportunity fund (QOF))? <input type="checkbox"/> No. STOP. Do not file this form with your tax return. <input checked="" type="checkbox"/> Yes. Go to line 3.		
3 Is this the first period the taxpayer is a QOF? <input checked="" type="checkbox"/> Yes. By checking this box, you certify that by the end of the taxpayer's first QOF year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in QOZ property and a description of the trade or business(es) that the QOF is engaged in either directly or through a QOZ business. See instructions. <input type="checkbox"/> No		
4 If you checked "Yes" on line 3, provide the first month in which the fund chose to be a QOF ▶		
5 Did any investor dispose of, in part or in whole, their equity interest in the fund? <input checked="" type="checkbox"/> Yes. Attach a statement with each investor's name, the date of disposal, and the interest that they transferred during the QOF's tax year. <input type="checkbox"/> No.		
6 <input checked="" type="checkbox"/> Check this box "only" if the taxpayer is electing to decertify as a QOF. If you check this box, provide the date the taxpayer elected to decertify as a QOF, and attach a statement to Form 8996 with additional information regarding decertification. See instructions ▶ December 1, 2020		

Sample Statement Accompanying Draft November 2020 Form 8996, Part I, Line 6
Election to Decertify as a Qualified Opportunity Fund

Pursuant to Treas. Reg. § 1.1400Z2(d)-1(a)(3), XYZ QOF LLC, a limited liability company organized under the laws of State X, hereby elects by checking the box on Line 6 of Form 8996 to voluntarily decertify as a Qualified Opportunity Fund on December 1, 2020, which election to decertify as a Qualified Opportunity Fund shall become effective on January 1, 2021.

Date QOF Elects to Decertify	Effective Date of QOF Self-Decertification
12/01/2020	01/01/2021

Because the election by XYZ QOF LLC would have been an inclusion event for both taxpayers A and B, the QOF in this example would also have needed to include a statement required by Line 5 of Form 8996 regarding each investor that disposed of an interest in the QOF on the date on which the QOF decertification election became effective.¹⁰⁷

¹⁰⁷ I.R.S. Instructions for Form 8996, at *4 (Dec. 2021) (describing the required statement).

The following is an example of the statement XYZ QOF LLC might have been filed in connection with its voluntary decertification as a QOF to comply with Line 5's requirement.

Sample Statement Accompanying Form 8996, Part I, Line 5 Statement of Investor Dispositions from Qualified Opportunity Fund Decertification		
<p>The following statement is provided by XYZ QOF LLC in connection with the investors that are deemed to have disposed of their entire equity interest in the fund upon the decertification of XYZ QOF LLC as a Qualified Opportunity Fund effective on and after January 1, 2021.</p>		
Investor	Date of Disposal	Interest Disposed of by Investor
A	01/01/2021	50% Partnership Interest in XYZ QOF LLC
B	01/01/2021	50% Partnership Interest in XYZ QOF LLC

This simple example illustrates one important issue with respect to the proposed QOF decertification procedure on the November 2020 draft Form 8996. At the time this form was promulgated, the draft Instructions for Form 8996 provided that the QOF's election to decertify becomes effective on the first day of the month after the month set forth by the QOF as the date of its decertification election on Line 6 of the November 2020 draft Form 8996.¹⁰⁸ Yet if a QOF, like XYZ QOF LLC, checked the box on Line 6 of the November 2020 draft Form 8996 to elect to decertify as a QOF in the final month of its 2020 taxable year, that voluntary decertification election would not have become effective until the first day of the first month the eligible entity's *next* taxable year (that is, XYZ QOF LLC's 2021 tax year), during which the entity would not be a QOF for any part of the taxable year.¹⁰⁹ In this example, that could potentially lead to a reporting gap because XYZ QOF LLC's final Form 8996 would be filed for the 2020 taxable year (i.e., the year beginning on January 1, 2020 and ending on December 31, 2020),

¹⁰⁸ I.R.S. Draft Instructions for Form 8996, at *4 (Nov. 4, 2020) (describing the required statement).

¹⁰⁹ See Treas. Reg. § 1.1400Z2(d)-1(a)(1)(i) (as amended in 2020) ("In order to be treated as a QOF, an eligible entity *must self-certify* on an annual basis that it satisfies the requirements of paragraphs (b) and (c) of this section, as appropriate") (emphasis added).

and the QOF would not, and indeed could not, file Form 8996 for the 2021 taxable year (i.e., the tax year, beginning on January 1, 2021).¹¹⁰

Nevertheless, prior to the 2021 correcting amendments, XYZ QOF LLC's investors—taxpayers A and B—would have had inclusion events on January 1, 2021, which is the first day of the first month following the QOF's election to decertify as such, and it is unclear from the November 2020 draft Instructions for Form 8996, or the draft form itself, how the QOF should have reported its investors' deemed dispositions as a result of the decertification of the QOF on Line 5 of Form 8996.¹¹¹

While the Treasury Department and IRS made clear in the final regulations under section 1400Z-2 that the decertification of a QOF is an inclusion event, the regulations do not specify when that inclusion event occurs.¹¹² Prior to the 2021 correcting amendments, a QOF's election to self-decertify in the last month of its taxable year would have resulted in an inclusion event on the first day of the first month following the election to decertify.¹¹³ Thus, in the above example, taxpayers A and B would have had an inclusion event under Treas. Reg. § 1.1400Z2(b)-1(c)(15) on January 1, 2021, rather than on December 31, 2020. In such a case, it is not clear whether, under the draft November 2020 Form 8996, the IRS would have required XYZ QOF LLC's report on investor dispositions illustrated above to have been filed along with the QOF's final Form 8996 for the 2020 tax year, even though the date of the investors' dispositions would not have been until January 1, 2021, under the version of the final regulations in effect prior to the correcting amendments issued on August 5, 2021.¹¹⁴

Despite its potential flaws, the IRS's initial attempt to provide a check-the-box regime for decertifying QOFs was relatively simple and aligned with Form 8996's straightforward mechanism for eligible entities to elect QOF status.¹¹⁵ Instead of this simplified procedure for the election to decertify as a QOF, however, the IRS published a final version of the 2021 Form 8996

¹¹⁰ Treas. Reg. § 1.1400Z2(b)-1(c)(15) (as amended in 2020).

¹¹¹ See Treas. Reg. § 1.1400Z2(b)-1(c)(15) (as amended in 2020) (defining as an inclusion event the decertification of a QOF—including presumably the effective date of a voluntary decertification election, and not merely the date of such election); I.R.S. Draft Form 8996, Part I, Line 2 at *1 (Nov. 6, 2020) (prohibiting an entity from filing Form 8996 unless it is organized for the purpose of investing in QOZP); I.R.S. Draft Instructions for Form 8996, at *4 (Nov. 4, 2020) (describing the statements required for decertifying QOFs, as well as QOFs whose investors are deemed to dispose of an interest in the QOF, but not identifying its potential inconsistency with Line 2 of Part I of the form).

¹¹² See Treas. Reg. § 1.1400Z2(b)-1(c)(15) (as amended in 2020).

¹¹³ T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1978 (Jan. 13, 2020) (to be codified at 25 C.F.R. pt. 1).

¹¹⁴ See generally T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1897 (Jan. 13, 2019) (to be codified at 25 C.F.R. pt. 1) (describing the self-decertification provision's timing rules prior to the 2021 correcting amendments).

¹¹⁵ See Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi)(A) (describing by example how the Treasury's anti-abuse rule functions as a counterweight to IRS Form 8996's simple self-certification regime for QOFs).

for QOFs in January 2021 that reserved Line 6 “for future use” and expurgated all references to QOF decertification from the Instructions for Form 8996.¹¹⁶ QOFs that had been intending to decertify under the draft form’s check-the-box election were instructed by the final form: “Do not check this box.”¹¹⁷

The November 2020 draft Form 8996, and its instructions, promulgated, then withdrawn by the IRS, offered a simple option for taxpayers seeking to avoid penalties resulting from a failed project in a QOZ by allowing them to elect to voluntarily revoke their status as QOFs. The same revocation would have also provided an option—short of the expensive private letter ruling process—for eligible entities that intended to be classified as QOZBs and inadvertently filed Form 8996, resulting in their being treated as QOFs, to avoid the potentially disastrous consequences attendant to such treatment for their respective QOF investors (as set forth in the introduction to this article).¹¹⁸ Check-the-box decertification would have mirrored the voluntary process for eligible entities organized as tax partnerships or corporations for the purpose of investing in QOZP to self-certify as QOFs on Line 2 of Form 8996.¹¹⁹ Without a mechanism on Form 8996 or elsewhere to allow a QOF to voluntarily decertify, entities could be subjected to penalties for as long as they are in existence, even in circumstances in which meeting the ninety percent investment standard is no longer practicable as a business matter.¹²⁰

The remainder of this article summarizes the guidance under the final regulations on the time, place, and manner of QOF decertification and explains how that guidance has changed following the release, then removal, of the check-the-box decertification option on Form 8996. It concludes by addressing how the lack of guidance on the decertification of QOFs has affected taxpayers and their advisors, who may be forced to resort to a mechanism not expressly authorized by IRS forms, instructions, or guidance to ensure that taxpayers are protected when such guidance is ultimately issued by the IRS.

¹¹⁶ Compare I.R.S., Draft Form 8996, at *1 (Nov. 6, 2020) (“Check this box “only” if the taxpayer is electing to decertify as a QOF.”), with I.R.S. Form 8996, Line 6, at *1 (Dec. 2021) (“Do not check this box. Reserved for future use.”).

¹¹⁷ I.R.S. Form 8996, Line 6, at *1 (Dec. 2021).

¹¹⁸ See Letter from Joseph Darby, *supra* note 5, at *2–3 (referencing the IRS National Office’s response that it lacked the statutory or regulatory authority to revoke inadvertent QOF self-certification elections made by entities intending to be classified as QOZBs in 2019).

¹¹⁹ See I.R.S. Form 8996, at *1 (Dec. 2021).

¹²⁰ See I.R.C. § 1400Z-2(f)(1).

E. The Certification and Decertification of Qualified Opportunity Funds

1. Self-Certification

Congress expressly authorized the Treasury Department and IRS to prescribe by regulations “rules for the certification of qualified opportunity funds for the purposes of this section [1400Z-2].”¹²¹ The legislative history of the QOZ program indicates that Congress intended that “the certification process for a qualified opportunity fund will be done by the [Community Development Financial Institutions Fund (CDFI)] in a manner similar to the process for allocating the new markets tax credit.”¹²² Nevertheless, shortly after the QOZ program was enacted, on April 24, 2018, the IRS released Opportunity Zone Frequently Asked Questions, that explained that an eligible entity would be allowed to “self-certify” to become a QOF.¹²³ Unlike the New Markets Tax Credit Program, there has never been a requirement for a QOF to receive Treasury Department’s imprimatur in order to receive investments eligible for tax advantages.¹²⁴

In order to be treated as a QOF, an eligible entity must self-certify on an annual basis on Form 8996, Qualified Opportunity Fund, that it satisfies the requirements of section 1400Z-2(d)(1), Treas. Reg. § 1.1400Z2(d)-1(b), and Treas. Reg. § 1.1400Z2(d)-1(c), as appropriate.¹²⁵ The following rules apply to the required self-certification of an eligible entity as a QOF. In general, the self-certification must be timely-filed and effected annually on Form 8996, filed with a timely filed federal income tax return (including extensions of the filing deadline) or in such form and manner as may be prescribed by the Commissioner of Internal Revenue in the Internal Revenue Service (IRS) forms or instructions under Treas. Reg. § 601.602, or in publications or guidance published in the Internal Revenue Bulletin under Treas. Reg. § 601.601(d)(2).¹²⁶

¹²¹ I.R.C. § 1400Z-2(e)(4)(A).

¹²² Joint Comm. on Tax’n, JCX-56-17, Description of the Chairman’s Modification to the Chairman’s Mark of the “Tax Cuts and Jobs Act” 53 (2017).

¹²³ See *Opportunity Zones Frequently Asked Questions*, I.R.S. (Apr. 24, 2018), <https://www.irs.gov/credits-deductions/opportunity-zones-frequently-asked-questions#qualifiedoppfunds>; Wendi Kotzen et al., *IRS Allows Self-Certification of Qualified Opportunity Funds*, JD SUPRA (May 8, 2018), <https://www.jdsupra.com/legalnews/irs-allows-self-certification-of-63313/>.

¹²⁴ Treas. Reg. § 1.1400Z2(d)-1(a)(2) (as amended in 2020) (describing the rules applicable to certification of QOFs as one of self-certification).

¹²⁵ Treas. Reg. § 1.1400Z2(d)-1(a)(1) (as amended in 2020) (“In order to be treated as a QOF, an eligible entity must self-certify on an annual basis that it satisfies the requirements of paragraphs (b) and (c) of this section, as appropriate.”).

¹²⁶ Treas. Reg. § 1.1400Z2(d)-1(a)(2)(i) (as amended in 2020); see also I.R.S. Instructions for Form 8996, at *1, *4 (Dec. 2021) (describing the purpose of Form 8996 as the self-certification form for QOFs).

For the eligible entity's first taxable year as a QOF, the entity must identify the first taxable year for which the self-certification takes effect and may identify the first month (in that initial taxable year) in which the self-certification takes effect.¹²⁷ If the self-certification fails to specify the month in the initial taxable year that the self-certification takes effect, then the self-certification is treated as taking effect in the first month of that taxable year.¹²⁸

If an investment in eligible interests of an eligible entity occurs prior to the eligible entity's first month as a QOF, any election under section 1400Z-2(a)(1) made for that investment is invalid, and the investment is a non-qualifying investment.¹²⁹ In the case of an eligible entity that has self-certified as a QOF, the assets owned or leased by the QOF must satisfy the ninety percent investment standard in section 1400Z-2(d)(1).¹³⁰ To meet the ninety percent investment standard in section 1400Z-2(d)(1), on a semiannual basis, a QOF may value its assets using the applicable financial statement valuation method set forth in Treas. Reg. § 1.1400Z2(d)-1(b)(3), if the QOF has an applicable financial statement within the meaning of Treas. Reg. § 1.475(a)-4(h), or the alternative valuation method set forth in Treas. Reg. § 1.1200Z2(d)-1(b)(4).¹³¹ During each taxable year, a QOF must consistently apply the valuation method that it selects under Treas. Reg. § 1.1400Z2(d)-1(b) to all assets valued with respect to the taxable year.¹³²

2. Decertification of a QOF.

i. In general.

In the October 2018 proposed regulations, the Treasury Department and the IRS announced an intention to publish additional guidance regarding QOF decertification.¹³³ Comments were submitted by the New York State Bar Association to the Treasury Department and IRS on this topic, including comments requesting a mechanism to permit a QOF to self-decertify, as well as comments requesting guidance on the ability of the IRS to decertify a

¹²⁷ Treas. Reg. § 1.1400Z2(d)-1(a)(2)(iii) (as amended in 2020); *see also* I.R.S. Form 8996, Part I, Line 4, at *1 (Dec. 2021).

¹²⁸ Treas. Reg. § 1.1400Z2(d)-1(a)(2)(iii)(A) (as amended in 2020).

¹²⁹ Treas. Reg. § 1.1400Z2(d)-1(a)(2)(iii)(B) (as amended in 2020).

¹³⁰ Treas. Reg. § 1.1400Z2(d)-1(b)(1)(i) (as amended in 2020).

¹³¹ Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i)(A) (as amended in 2020).

¹³² *See* Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i)(A) (as amended in 2020); I.R.S. Form 8996, Part VI, Line 4, at *3 (Dec. 2021) (providing the mechanism for the QOF to elect a valuation method for each taxable year reported on Form 8996).

¹³³ *See* T.D. 9889, Investing in Qualified Opportunity Funds, 83 Fed. Reg. 54279, 54283 (Oct. 29, 2018) (to be codified at 26 C.F.R. pt. 1) (“The Treasury Department and the IRS intend to publish additional proposed regulations that will address, among other issues, the applicability of the section 1400Z-2(f)(1) penalty and conduct that may lead to potential decertification of a QOF”).

QOF.¹³⁴ The Tax Section of the New York State Bar Association emphasized in *Report No. 1407 on Proposed Qualified Opportunity Zone Regulations under Section 1400Z-2*, submitted to the Treasury Department and IRS on January 10, 2019, that further clarification of “conduct that may lead to potential decertification of a QOF” was necessary in helping clients to develop “an understanding of the risks and ‘downside’ scenarios” involved in tax planning surrounding investments in low-income communities designated as QOZs.¹³⁵ The report requested that the final regulations under section 1400Z-2 provide examples of situations in which a QOF would be involuntarily decertified as such in order to ameliorate uncertainties surrounding the QOF provisions related to potential QOF decertification that made appropriate tax planning for such downside risks of opportunity zone investments difficult to determine or control.¹³⁶

The Treasury Department and the IRS included in the final regulations a provision to allow a QOF to self-decertify but expressly reserved the topic of involuntary QOF decertification until additional guidance is issued.¹³⁷ The rule on QOF self-decertification originally published in the Federal Register on January 13, 2020, prior to its amendment on August 5, 2021, specified that an eligible entity’s self-decertification becomes effective at the beginning of the month following the month specified by the taxpayer and that such month could “not be earlier than the month in which the taxpayer files its self-decertification.”¹³⁸

Thus, prior to the Treasury Department’s issuance of the 2021 correcting amendments, the Preamble to the final regulations on Investing in Qualified Opportunity Funds (T.D. 9889) included the following example of the timing of the applicable QOF self-decertification process: “[I]f a QOF wishes to decertify on May [1], the earliest date that the QOF could be decertified would be June 1st, provided that all applicable procedures were followed.”¹³⁹ The IRS further embellished that example in the draft Instructions for Form 8996, released on November 4, 2020, which provided the following information with respect to the QOF’s check-the-box decertification election on Line 6 of the draft form:

¹³⁴ N.Y. State Bar Ass’n, Rep. No. 1407, Report on Proposed Qualified Opportunity Zone Regulations under Section 1400Z-2 62 (2019).

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ T.D. 9889, Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1897 (Jan. 13, 2019) (to be codified at 26 C.F.R. pt. 1) (“[T]he Treasury Department and the IRS continue to consider the circumstances under which involuntary decertification of a QOF would be warranted, and intend to propose guidance regarding those circumstances.”).

¹³⁸ *See id.*

¹³⁹ *Id.*

Line 6

Check this box only if you are electing to decertify as a QOF. The election to decertify as a QOF is voluntary. If you make this election you must attach a statement to the Form 8996 making this election along with the date of the election.

The election to decertify becomes effective on the first day of the month after the month in which the QOF elects to decertify as a QOF. For example, if an entity elects to decertify on July 1, the decertification becomes effective on August 1.¹⁴⁰

The draft Form 8996, released two days after those instructions appeared on the IRS website, included a new Line 6 in Part I of Form 8996, with the option to check this box and decertify as a QOF.¹⁴¹ Despite these draft instructions, and the new line on Form 8996, that the IRS promulgated in November 2020, the QOF's check-the-box decertification election never became operative and the time, place, and manner for filing a decertification election with the IRS remains a mystery.¹⁴²

In January 2021, the IRS published a final Form 8996 for the 2020 tax year that removed the option for QOFs to decertify by checking the box on Line 6 of the form.¹⁴³ Line 6 of Part I of Form 8996 is now simply reserved for future use.¹⁴⁴ The final IRS Instructions for Form 8996 make no mention of QOF decertification.¹⁴⁵ Further, on August 5, 2021, the Treasury Department and IRS issued correcting regulations, more than 18 months after the final regulations under section 1400Z-2 were promulgated, that retroactively modified the timing with respect to the QOF decertification election and the effective date of that election.¹⁴⁶ As corrected, Treas. Reg. § 1.1400Z2(d)-1(a)(3) now provides no information about when a QOF decertification election becomes effective and simply states that a self-decertification must be effected in such form and manner as the IRS may prescribe in yet-to-be-issued forms and instructions.¹⁴⁷ No mechanism for

¹⁴⁰ I.R.S. Draft Instructions for Form 8996, at *4 (Nov. 4, 2020).

¹⁴¹ I.R.S., Draft Form 8996, Line 6, at *1 (Nov. 6, 2020) (“Check this box “only” if the taxpayer is electing to decertify as a QOF.”).

¹⁴² See generally I.R.S. Form 8996, Qualified Opportunity Fund, Part I, Line 6, at *1 (Dec. 2021) (reserving this box for future use, but not providing any check-the-box decertification election); I.R.S. Instructions for Form 8996, Qualified Opportunity Fund, at *4 (Dec. 2021) (“Line 6. Do not check this box. Skip this line.”).

¹⁴³ I.R.S. Form 8996, Qualified Opportunity Fund, Part I, at *1 (Dec. 2021).

¹⁴⁴ *Id.*

¹⁴⁵ I.R.S. Instructions for Form 8996, Qualified Opportunity Fund, at *1, *4 (Dec. 2021).

¹⁴⁶ T.D. 9889, Investing in Qualified Opportunity Funds; Correcting Amendments, 86 Fed. Reg. 42715 (Aug. 5, 2021) (removing all of the language in the Preamble relevant to explaining the timing of a QOF decertification election and its effective date).

¹⁴⁷ *Id.*

retroactive QOF self-decertification election is specifically allowed under the amended QOF self-decertification provision, although retroactive decertification of a QOF is not prohibited by the rules either.¹⁴⁸

As indicated, the current rules for voluntary decertification of a QOF leave the timing of, and the place and manner for, QOF self-decertification to forms or instructions provided by the IRS under Treas. Reg. § 601.602 and/or publications or guidance published in the Internal Revenue Bulletin under Treas. Reg. §601.601(d)(2). At present, however, the Treasury Department and the IRS are still developing additional instructions regarding QOF self-decertification, including instructions regarding the time, form, and manner of QOF self-decertification, leaving tax planning with respect to QOFs seeking to decertify in limbo, without a viable means of doing so in accordance with the current rules.¹⁴⁹

ii. Involuntary Decertification.

As discussed, the Treasury Department and IRS have never directly addressed what conduct may lead the IRS to decertify a QOF, although the government intends to issue guidance on the subject at some point.¹⁵⁰ Nevertheless, an example under the anti-abuse rules for the QOZ program may provide a clue as to the types of abusive behavior that may result in the involuntary decertification of a QOF.¹⁵¹ The example under the anti-abuse rules involves individuals that intend to sell stock at a capital gain and invest the resulting gain in a QOF pursuant to a deferral election under section 1400Z-2(a).¹⁵² Although the individuals form the eligible entity and file IRS Form 8996 (Qualified Opportunity Fund) formally certifying that the eligible entity is a QOF organized for the purpose of investing in QOZP, the individuals have no intention of investing in such property, within the meaning of section 1400Z-2(d)(2), including direct or indirect investments through a first-tier operating entity (i.e., a QOZB) in tangible property that is QOZBP used in a trade or business of the QOF or its QOZB subsidiary in a QOZ. Instead, from the outset of their investment in the self-certified investment vehicle, that (falsely) files Form 8996, certifying that it is “organized for the purpose of investing in qualified opportunity zone (QOZ) property (other than another qualified opportunity fund (QOF)),”¹⁵³ the individuals intend to invest through that vehicle in non-qualifying property,

¹⁴⁸ See generally *id.*

¹⁴⁹ See Treas. Reg. § 1.1400Z2(d)-1(a)(3) (2020).

¹⁵⁰ See U.S. Dep’t of the Treas., Investing in Qualified Opportunity Funds (REG-115420-18), 83 Fed. Reg. 54279, 54283 (Oct. 29, 2018).

¹⁵¹ See Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi) (Example 6) (2020).

¹⁵² *Id.*

¹⁵³ I.R.S. Form 8996, Qualified Opportunity Fund, Part I, Line 2, at *1 (Dec. 2021).

such as publicly-traded stocks, bonds, and other securities, hoping that over ten years the property will appreciate substantially in value so that the individuals' tax-free gain under section 1400Z-2(c) will exceed the present value of the penalties incurred each year under section 1400Z-2(f)(1) due to the purported QOF's failure to maintain ninety percent of its assets in QOZP during any taxable year of the entity.¹⁵⁴ Each year, through the tenth anniversary of the taxpayers' investments in the eligible entity, the eligible entity in which the individuals invest files Form 8996 and pays the applicable penalty under section 1400Z-2(f)(1), calculated in accordance with the guidance on Part IV of Form 8996.¹⁵⁵ After holding their interests in the eligible entity for ten years, the individuals sell their interest in the eligible entity for a substantial gain and make an election to exclude the appreciation on their investment under section 1400Z-2(c).¹⁵⁶

On these facts, set forth in Example 6 under Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi), the final regulations under section 1400Z-2 make clear that a general anti-abuse rule under Treas. Reg. § 1.1400Z2(f)-1(c)(1) will apply.¹⁵⁷ The anti-abuse rule allows the Treasury Department and IRS to police the QOZ Program to ensure that the rules applicable to QOFs and their investors are being "applied in a manner consistent with the purposes of section 1400Z-2 and the section 1400Z-2 regulations."¹⁵⁸ Because section 1400Z-2's legislative history does not necessarily make section 1400Z-2's purpose entirely clear, the Treasury Regulations under section 1400Z-2 do make clear what Treasury and the IRS regard as the primary purposes of the QOZ Program and how the anti-abuse rule will apply:

The purposes of section 1400Z-2 and the section 1400Z-2 regulations are [1] to provide specified Federal income tax benefits to owners of QOFs to encourage the making of longer-term investments, through QOFs and qualified opportunity zone businesses, of new capital in one or more qualified opportunity zones and [2] to increase the economic growth of such qualified opportunity zones. Accordingly, if a significant purpose of a transaction is to achieve a Federal income tax result that is inconsistent with the purposes of section 1400Z-2 and the section 1400Z-2 regulations, a transaction (or series of transactions) will be recast or recharacterized for Federal tax purposes as appropriate to achieve tax results that are consistent

¹⁵⁴ Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi)(A) (2020).

¹⁵⁵ See Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi); I.R.S. Form 8996, Qualified Opportunity Fund, Part IV, at *2 (Dec. 2021) (setting forth the penalty calculation under section 1400Z-2(f)(1)).

¹⁵⁶ Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi)(A) (2020).

¹⁵⁷ Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi)(B) (2020).

¹⁵⁸ Treas. Reg. § 1.1400Z2(f)-1(c)(1) (2020).

with the purposes of section 1400Z-2 and the section 1400Z-2 regulations.¹⁵⁹

In the context of Example 6 of the anti-abuse rules, the QOZ Program's anti-abuse rule kicks in to disqualify the investment in the eligible entity as an investment in a QOF for purposes of section 1400Z-2(a) through (c).¹⁶⁰ The Treasury Department and IRS conclude that, with respect to this investment scheme, a "significant purpose of the transaction is to achieve a tax result that is inconsistent with the purposes of section 1400Z-2 and the section 1400Z-2 regulations," namely (1) to provide specified federal income tax benefits to owners of QOFs to encourage the making of longer-term investments, through QOFs and QOZBs, of new capital in one or more qualified opportunity zones and (2) to increase the economic growth of such QOZs.¹⁶¹ In Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi)(B), the Treasury Department and IRS provide an analysis of the example's facts that provides that the transaction will be recast and recharacterized for federal tax purposes so that the eligible entity is not a QOF and the individuals are not eligible for the elections under sections 1400Z-2(a) and (c). Under these circumstances, the eligible entity is not merely involuntarily decertified as a QOF, but decertified *retroactively*, so that it never became a QOF and its investors never made a deferral election, sufficient to trigger any of the benefits under section 1400Z-2.¹⁶²

iii. Voluntary Self-Decertification and COVID-19 Related Penalties Relief for QOFs and their investors.

In response to the ongoing COVID-19 pandemic, the IRS issued Notice 2020-39, 2020-26 IRB 984 (Jun. 22, 2020) and 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.¹⁶³ As a corollary to that relief,

¹⁵⁹ *Id.*

¹⁶⁰ Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi)(B) (2020).

¹⁶¹ See Treas. Reg. § 1.1400Z2(f)-1(c)(1) (2020); Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi) (2020).

¹⁶² Treas. Reg. § 1.1400Z2(f)-1(c)(3)(vi) (Example 6) (2020).

¹⁶³ For example, I.R.S. Notice 2020-39 and I.R.S. Notice 2021-10, together with updates to Qualified Opportunity Zones Frequently Asked Questions ("FAQs"), extended the time period for taxpayers to invest certain eligible gain in a QOF from 180 days under I.R.C. § 1400Z-2(a)(1)(A) to as many as 821 days in the case of qualified section 1231 gain. See Extension of Relief for Qualified Opportunity Funds & Invs. Affected by Ongoing Coronavirus Disease 2019 Pandemic, 2021-7 I.R.B. 888 (Feb. 16, 2021), amplifying Relief for Qualified Opportunity Funds & Invs. Affected by Ongoing Coronavirus Disease 2019 Pandemic, Notice 2020-39, 2020-26 IRB 984 (Jun. 22, 2020), and modifying Update to Notice 2020-18, Additional Relief for Taxpayers Affected by Ongoing Coronavirus Disease 2019 Pandemic, 2020-18 I.R.B. 742 (2020) Notice 2020-23, 2020-18 IRB 742

IRS Notices 2020-39 and 2021-10 potentially make it easier for self-certified investment vehicles that no longer have viable projects in a QOZ to decertify as QOFs without incurring penalties.¹⁶⁴ In particular, Notice 2020-39 provided, in the case of a QOF whose (i) last day of the first 6-month period of the taxable year or (ii) last day of the taxable year falls within the period beginning on April 1, 2020, and ending on December 31, 2020, any failure by that QOF to hold, on average, at least ninety percent of its assets in QOZP for that taxable year of the QOF (i) is due to reasonable cause under section 1400Z-2(f)(3), so that penalties will not apply to the QOF for the taxable year under section 1400Z-2(f); and (ii) is disregarded for purposes of determining whether the QOF or any otherwise qualifying investments in that QOF satisfy the requirements of section 1400Z-2 and the section 1400Z-2 regulations for any taxable year of the QOF.¹⁶⁵ That is, investments in the QOF are eligible for deferral of capital gains under section 1400Z-2(a)(1)(A) even if the QOF cannot establish that it can satisfy the ninety percent investment standard during tax year 2020 and no penalties are imposed during that taxable year for a failure of that ninety percent investment standard of the QOF in QOZP.¹⁶⁶

Notice 2021-10, among other things, extends the automatic relief originally provided under Notice 2020-39 by eliminating 2020 *and* 2021 penalties imposed on certain QOFs that fail to hold, on average, at least ninety percent of their assets in QOZ property (i.e., the ninety percent investment standard), including qualifying direct and indirect investments through a QOZB in QOZ Business 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 ninety percent investment standard").¹⁶⁷ The relief with respect to the application of the ninety percent investment standard is automatic.¹⁶⁸ QOFs do not have to send letters or other documents to the IRS in order to receive it.¹⁶⁹ However, Notice 2021-10

(Apr. 27, 2020); I.R.S., Opportunity Zones Frequently Asked Questions, Q&A 17 (Dec. 15, 2020) ("If your 1231 gain was realized in 2019, your 180-day period may begin on December 31, 2019.").

¹⁶⁴ See I.R.S. Notice 2021-10, 2021-7 IRB 888, Part IV.A (Feb. 16, 2021) (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 ninety percent investment standard, as required by section 1400Z-2(f)(3) for purposes of avoiding penalties); I.R.C. § 1400Z-2(f)(1) (imposing penalties on QOFs that fail to maintain a minimum ninety percent of their assets in QOZ property, as defined in section 1400Z-2(d)(2)(A)); I.R.C. § 1400Z-2(f)(3) (exempting from penalties taxpayers showing reasonable cause for failing to maintain the ninety percent investment standard).

¹⁶⁵ I.R.S. Notice 2020-39, 2020-26 I.R.B. 984, Part III.B (Jun. 22, 2020).

¹⁶⁶ *Id.*

¹⁶⁷ See I.R.S. Notice 2021-10, 2021-7 IRB 888, Part IV.A (Feb. 16, 2021); I.R.C. § 1400Z-2(f)(1); I.R.C. § 1400Z-2(f)(3).

¹⁶⁸ I.R.S. Notice 2021-10, 2021-7 IRB 888, Part IV.A (Feb. 16, 2021).

¹⁶⁹ *Id.*

requires the QOF to file Form 8996 with respect to each affected tax year with the QOF's timely-filed federal income tax return (including extensions) for such year(s).¹⁷⁰ The QOF must accurately complete all of the required information on all lines of Form 8996, except that the QOF should enter "0" on Line 8 of Part IV and Line 15 of Part III of the form to reflect the amount of the penalty under section 1400Z-2(f) is zero for the affected taxable year(s) due to the deemed good cause exception provided by Notice 2021-10.

The waiver of the ninety percent 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 ninety percent investment standard including with respect to investments made in QOZBs that fail to satisfy QOZB requirements during this period.¹⁷¹ QOFs funded with tax-deferred proceeds by January 31, 2021, that will no longer be moving forward with QOZ investments should consider decertifying on or before December 31, 2021, in order to apply the waiver and avoid penalty.¹⁷²

As discussed above, Treas. Reg. § 1.1400Z2(d)-1(a)(3) 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."¹⁷³ While the IRS provided a check-the-box election to self-decertify as a QOF on Line 6 of Part I of the November 6, 2020, draft of Form 8996, Qualified Opportunity Fund, and instructions thereto, released on November 4, 2020, that QOF self-decertification election was eliminated in the final version of Form 8996 released in February 2021.¹⁷⁴ 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.¹⁷⁵

It remains to be seen whether subsequent versions of IRS Form 8996

¹⁷⁰ *Id.*

¹⁷¹ See Notice 2021-10, 2021-7 IRB 888, Part IV.A (Feb. 16, 2021); I.R.S. Instructions for Form 8996, Qualified Opportunity Fund, at *3 (Feb 2, 2021) (illustrating in Example 3 the application of the ninety percent investment standard's semiannual testing date in the case of a partnership formed in January 2020).

¹⁷² Treas. Reg. § 1.1400Z2(d)-1(a)(3) (requiring QOF decertification in an IRS-prescribed form/manner); see I.R.S. Form 8996, Qualified Opportunity Fund (Jan. 2021); I.R.S. Instructions for Form 8996, Qualified Opportunity Fund (Jan. 2021).

¹⁷³ Treas. Reg. § 1.1400Z2(d)-1(a)(3), as amended by T.D. 9889, Investing in Qualified Opportunity Funds; Correcting Amendments, 86 Fed. Reg. 42716 (Aug. 5, 2021).

¹⁷⁴ Compare I.R.S., Draft Form 8996, Qualified Opportunity Fund, Line 6, at *1 (Nov. 6, 2020) ("Check this box 'only' if the taxpayer is electing to decertify as a QOF."), with I.R.S. Form 8996, Qualified Opportunity Fund, Line 6, at *1 (Dec. 2021) ("Do not check this box. Reserved for future use.").

¹⁷⁵ See I.R.S. Form 8996, Qualified Opportunity Fund (Jan. 2021); I.R.S. Instructions for Form 8996, Qualified Opportunity Fund (Jan. 2021).

will allow for retroactive decertification of QOFs, including for QOFs intending to decertify as such before the relief from penalties under Notice 2021-10 runs out for taxable years ending after January 2021.¹⁷⁶ To be eligible for relief from QOF penalties under Part IV.A of Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021), the last day of the first six-month period of the QOF's taxable year (or the last day of the QOF's taxable year) would have to include a date between April 1, 2020, and June 30, 2021. Therefore, if an eligible entity has a calendar year as its taxable year, the entity would have to have been formed and self-certified as a QOF by January 31, 2021, in order to qualify for relief from 2021 penalties under section 1400Z-2(f)(1) by virtue of Notice 2021-10. For a QOF formed within that time period, Notice 2021-10's deemed good-cause exception for penalties for failure to satisfy the ninety percent investment standard of QOFs means that no penalties will be imposed on the QOF for the entire 2021 tax year.¹⁷⁷

Example 4. Penalties Relief under Notice 2021-10. On July 5, 2019, A and B each realize a \$25 million capital gain on the sale of an asset to an unrelated person. For purposes of this example, assume that the entire \$50 million is eligible to be invested in a QOF. On December 31, 2019, A and B each contribute \$25 million cash to an equal partnership, QOF, organized for purposes of investing in QOZP. The partnership's taxable year is a calendar year. Assume that as of December 31, 2019, the QOF has a statement in its QOF operating agreement describing the entity's purpose of investing in QOZP (other than another QOF) and a description of the trade or business that the QOF intends to engage in directly or through a

¹⁷⁶ To be eligible for relief from QOF penalties under Part IV.A of Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021), the last day of the first 6-month period of the QOF's taxable year (or the last day of the QOF's taxable year) would have to include a date between April 1, 2020 and June 30, 2021. Therefore, if an eligible entity has a calendar year as its taxable year, it would have to be formed and self-certified as a QOF by January 31, 2021, in order to qualify for relief from 2021 penalties under section 1400Z-2(f)(1) by virtue of its deemed good cause for failing to hold ninety percent of its assets in QOZP as of the QOF's semiannual testing dates in 2021. By contrast, no relief from penalties for the QOF's failure to satisfy the ninety percent investment standard would be available for the 2022 taxable year of the QOF. If the eligible entity remained a QOF as of January 1, 2022, and makes a decertification election that is effective on that date, the QOF would still be assessed penalties under section 1400Z-2(f)(1) for 2022 if it holds less than ninety percent of its assets in QOZP on the last day of its last QOF taxable year (that is, January 1, 2022). If the QOF holds no QOZP on the date of its decertification as a QOF, then the penalty under section 1400Z-2(f)(1) would be assessed at the underpayment rate on ninety percent of the QOF's assets held on January 1, 2022, divided by 12 to exclude the 11 months in 2022 that the entity is not a QOF.

¹⁷⁷ See Notice 2021-10, 2021-7 I.R.B. 888, Part IV.A (Feb. 16, 2021); *see also* I.R.C. § 1400Z-2(d)(1) (generally, determining whether a QOF satisfies the ninety percent investment standard on the basis of a taxable year); I.R.C. § 1400Z-2(f)(1) (imposing a monthly penalty, but only if the QOF fails to satisfy the ninety percent investment requirement in QOZP as of the taxable year, based on the average of QOZP held by the QOF on its applicable semiannual testing dates under section 1400Z-2(d)(1) of the Code).

QOZB, as required by Form 8996 and the accompanying instructions.¹⁷⁸ Assume further that the partnership timely files Form 8996 for 2019, 2020, and 2021 certifying that it is a QOF organized for the purpose of investing in qualified opportunity zone property, but that the QOF does not make any investment during those years in QOZP, including (1) QOZ stock, (2) a QOZ partnership interest, or (2) QOZBP.

For the QOF's 2019 taxable year, a regulatory safe harbor allows a QOF to choose to determine compliance with the ninety percent investment standard by excluding from both the numerator and the denominator of the test the equity contributions made by A and B on the testing date of the QOF occurring on December 31, 2019.¹⁷⁹ Normally, since the QOF failed to hold at least ninety percent of its assets in QOZP based on the average of the percentages of QOZP held on June 30 and December 31 of 2020 and 2021, the QOF would be subject to a monthly penalty under section 1400Z-2(f)(1) for those years.¹⁸⁰ The monthly penalty in 2020 and 2021 would generally be based on the excess of ninety percent of the QOF's assets, over the amount of QOZP, held at the end of each month, multiplied by the underpayment rate applied to each applicable month in quarterly guidance issued by the IRS, which is set forth in the table below.¹⁸¹ While this penalty still has to be calculated and reported on Form 8996 for QOF's 2020 and 2021 tax years, because the semiannual testing dates of the QOF fall between April 1, 2020, and June 30, 2021, no penalties are owed by the QOF to the IRS for failing the ninety percent investment standard for either the 2020 or the 2021 taxable years and the investments by A and B in the QOF are eligible for deferral during 2019, 2020 and 2021, despite the QOF never having invested in QOZP during those years.¹⁸²

The tables below set forth the applicable underpayment rates from the fourth quarter of 2019 until the third quarter of 2022 and illustrate how Notice 2021-10 provides the QOF in the above example with \$1,800,000 of penalties relief in 2020 and \$1,350,000 of penalties relief in 2021.

¹⁷⁸ I.R.S. Form 8996, Qualified Opportunity Fund, Part I, Lines 2 & 3, at *1 (Dec. 2021); I.R.S. Instructions for Form 8996, Qualified Opportunity Fund, at *4 (Dec. 2021) (“If you answer ‘Yes’ on Line 2 [self-certifying as a QOF], then by the end of your first QOF year, the organizing documents should include a description of the trade(s) or business(es) that the QOF expects to engage in, either directly or indirectly through a first-tier operating entity (QOZ business).”)

¹⁷⁹ In general, there is also a requirement that the QOF hold the contributed amount (\$50 million) in cash, cash equivalents or debt instruments with a term of 18 months or less continuously from the fifth business day after the contribution . . . [until] the date of the semiannual test.” Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i)(B)(3). But since both the contribution and the testing date in this case are December 31, 2019, this rule is inapplicable for purposes of the safe harbor under Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i)(B).

¹⁸⁰ I.R.C. § 1400Z-2(f)(1).

¹⁸¹ I.R.S. Notice 2021-10 (2021).

¹⁸² See *id.*

Table of I.R.C. § 6621(a)(2) Underpayment Rates
From October 1, 2019 – September 30, 2022¹⁸³

Date	I.R.C. § 6621(a)(2) Underpayment Rates
July 1 – September 30, 2022	5%
April 1 – June 30, 2022	4%
January 1 - March 31, 2022	3%
October 1 - December 31, 2021	3%
July 1 – September 30, 2021	3%
April 1 - June 30, 2021	3%
January 1 – March 31, 2021	3%
October 1 – December 31, 2020	3%
July 1 – September 30, 2020	3%
April 1 - June 30, 2020	5%
January 1 – March 31, 2020	5%
October 1 – December 31, 2019	5%

The following table provides a computation of the penalty that would have been owed by QOF during 2020 and 2021 if Notice 2020-39 and Notice 2021-10 did not apply, and that must be reported by the QOF in Part IV of Forms 8996 for 2020 and 2021, except with a “0” included on Line 8 of Part IV of the form.¹⁸⁴

2020 Penalty Calculation under I.R.C. § 1400Z-2(f)(1) ¹⁸⁵													
		01/31 /20	02/29 /20	03/31 /20	04/30 /20	05/31 /20	06/30 /20	07/31 /20	08/31 /20	09/30 /20	10/31 /20	11/30 /20	12/31 /20
1	As set	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00	\$50.00
2	90%	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00
3	QOP	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
4	(2) – (3)	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00
5	Rate ¹⁸⁶	5%	5%	5%	5%	5%	5%	3%	3%	3%	3%	3%	3%
6	(4) x (5)	\$2.250,000	\$2.250,000	\$2.250,000	\$2.250,000	\$2.250,000	\$2.250,000	\$1.350,000	\$1.350,000	\$1.350,000	\$1.350,000	\$1.350,000	\$1.350,000
7	Divide by 12	\$187,500	\$187,500	\$187,500	\$187,500	\$187,500	\$187,500	\$112,500	\$112,500	\$112,500	\$112,500	\$112,500	\$112,500

¹⁸³ Rev. Rul. 2022-11, 2022-23 I.R.B. 1159 (June 6, 2022).

¹⁸⁴ See I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021).

¹⁸⁵ See I.R.S. Form 8996, Part IV, at *2 (Dec. 2021).

¹⁸⁶ Rev. Rul. 2022-11, 2022-23 I.R.B. 1159.

2021 Penalty Calculation under I.R.C. § 1400Z-2(f)(1) ¹⁸⁷													
		01/31 /21	02/29 /21	03/31 /21	04/30 /21	05/31 /21	06/30 /21	07/31 /21	08/31 /21	09/30 /21	10/31 /21	11/30 /21	12/31 /21
1	As set s	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0	\$50,0 00,00 0
2	x 90 %	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0
3	Q OZ P	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
4	(2) – (3)	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0	\$45,0 00,00 0
5	Ra te ¹⁸⁸	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
6	(4) x (5)	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000	\$1,35 0,000
7	Di vid e by 12	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500	\$112, 500

By contrast, no relief from section 1400Z-2(f) penalties is provided, pursuant to Notice 2021-10's deemed good-cause exception, for a QOF formed after January 31, 2021, or for QOFs formed by January 31, 2021, with respect to a taxable year ending after the year that includes a date no later than June 30, 2021, as one of its semiannual testing dates.¹⁸⁹

If, for example, an eligible entity formed and self-certified as a QOF by January 31, 2021, remained a QOF as of January 1, 2022, and makes a decertification election that is effective on January 1, 2022, the QOF would still be assessed penalties under section 1400Z-2(f)(1) for 2022 if it holds less than ninety percent of its assets in QOZP on the last day of its last QOF taxable year (that is, January 31, 2022). If the QOF holds no QOZP on the date of its decertification as a QOF, then the penalty under section 1400Z-2(f)(1) would be assessed at the underpayment rate on ninety percent of the QOFs assets held on January 1, 2022, divided by twelve to exclude the eleven months in 2022 that the entity is not a QOF.¹⁹⁰

Recall that prior to the 2021 correcting amendments, Treas. Reg. § 1.1400Z2(d)-1(a)(3)(ii) established a timing rule that would have precluded many QOFs from taking advantage of voluntary self-decertification in time to avoid penalties under Notice 2021-10. The previous version of the QOF decertification provision stated that voluntary decertification of a QOF could not become effective until the beginning of the month following the month in which the taxpayer files its self-decertification election with the IRS.

¹⁸⁷ See I.R.S. Form 8996, Part IV, at *2 (Dec. 2021).

¹⁸⁸ Rev. Rul. 2022-11, 2022-23 I.R.B. 1159 (June 6, 2022).

¹⁸⁹ I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021).

¹⁹⁰ I.R.S. Form 8996, Part IV, Lines 1-7, at *2 (Dec. 2021).

For example, under the timing rule for QOF decertification in effect before the August 5, 2021 correcting amendments, a QOF would have had to notify the IRS of its decertification election by *November 30, 2021*, in order for the decertification of the QOF to become *effective in December 2021*, which is the last month in which a taxpayer with no future plans to establish an opportunity zone business can decertify as a QOF and avoid penalties altogether under the COVID-19 disaster relief for QOFs and their investors provided in Notice 2021-10. By contrast, under that pre-amendment timing rule, a QOF that notified the IRS of its decertification election in December 2021 would have that decertification become effective in January 2022, when Notice 2021-10 provides no safe harbor from section 1400Z-2(f) penalties, resulting in at least one month's penalty being assessed at the underpayment rate on the excess of ninety percent of the decertifying QOF's assets over its holdings of QOZP, which is likely to be zero in the case of a fund without a viable QOZ project.

The 2021 correcting amendments removed the timing rule relating to QOF decertification, presumably because the IRS intends to specify the timing in sub-regulatory guidance.¹⁹¹ Under the revised decertification provision, it would appear at least that the IRS could issue a new Form 8996 that permits retroactive check-the-box decertification elections for QOFs, without the requirement that such a decertification election be filed before the month in which the QOF's decertification is to become effective. Indeed, it is difficult to understand the purport of the 2021 correcting amendments in any other manner than in permitting such retroactive decertification of QOFs that can no longer satisfy the requirements of the ninety percent investment standard after the grace period afforded by Notices 2020-39 and 2021-10 for the 2020 and 2021 tax year of certain QOFs.¹⁹²

F. Consequences of Decertification

1. *Consequences to Taxpayers of Decertification*

Except as noted above, in Example 6 of the anti-abuse regulations, there is no guidance on what sort of conduct will result in the involuntary decertification of a QOF. This lack of guidance may be intentional. After all, like the QOZ Program's anti-abuse rule itself, the IRS does not want to provide a roadmap for evasion of the program's purposes of encouraging the growth of economic activity in opportunity zones and long-term investments, through qualified opportunity funds and qualified opportunity zone

¹⁹¹ Treas. Reg. § 1.1400Z2(d)-1(e)(1)–(2) (2021) (providing the applicable date for the final regulations under Treas. Reg. § 1.1400Z2(d)-1, which includes the provision on QOF self-decertification).

¹⁹² See I.R.S. Notice 2021-10, 2021-7 I.R.B. 888 (Feb. 16, 2021).

businesses, in a trade or business operating within one or more census tracts designated as a QOZ. Rather, as the taxpayers in Example 6 of the anti-abuse rules demonstrate, the QOZ Program may be abused in a myriad of ways that would require IRS decertification of a QOF, but the actual use of the program in these ways is likely to be rare and difficult to circumscribe within the boundaries of an articulated rule. As Supreme Court Justice Potter Stewart described his threshold test for obscenity in *Jacobellis v. Ohio*,¹⁹³ the IRS may implicitly be taking an “I know it if I see it” approach to abuse of the QOF investment vehicle under the involuntary decertification rule.

For purposes of the QOZ program, the regulations under section 1400Z-2 provide that the decertification of a QOF, whether voluntary or involuntary, results in an inclusion event for each investor in that QOF and the end of the holding period for each such investor’s qualifying investment attributable to eligible gain invested in that QOF.¹⁹⁴ As a result, each investor in a decertifying QOF will generally be required to recognize deferred capital gain that was invested in that QOF in the year in which the entity’s self-decertification becomes effective.¹⁹⁵ However, a taxpayer may avoid this result by reinvesting an amount equivalent to the qualifying investment in a decertifying QOF in another self-certified QOF within a 180-day period, beginning on the effective date of the QOF decertification.¹⁹⁶

If, following a QOF’s decertification, a tax-deferred investor in the former QOF reinvests an amount equivalent to the eligible gain required to be recognized from the decertification in a new QOF within 180 days of the decertification, then the taxpayer’s investment in the new QOF is treated as a new qualifying tax-deferred investment, with a new holding period, for purposes of each of the basis step-ups available under the QOZ program.¹⁹⁷ As a result, a taxpayer that made a 2019 investment in a QOF (the “2019 QOF Investment”), which decertifies on January 1, 2020, could invest in a new QOF within 180 days of the former QOF’s decertification and, if that new QOF investment is held for at least five years from the 2020 acquisition date (the “2020 QOF Investment”), potentially qualify for a ten percent basis step-up with respect to the eligible gain required to be recognized by December 31, 2026.¹⁹⁸ But, while the taxpayer’s former 2019 QOF Investment in the now-decertified QOF could have qualified for a total fifteen percent basis step-up after a seven-year holding period reached in 2026, the taxpayer’s 2020 QOF Investment is not eligible for the additional five percent

¹⁹³ *Jacobellis v. Ohio*, 378 U.S. 184 (1964).

¹⁹⁴ See Treas. Reg. § 1.1400Z2(b)-1(c)(15) (2020).

¹⁹⁵ See Treas. Reg. § 1.1400Z2(b)-1(c)(15) (2020); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(A) (2020).

¹⁹⁶ See *id.*

¹⁹⁷ See Treas. Reg. § 1.1400Z2(b)-1(c)(15) (2020); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(B) (2020); Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(C) (2020).

¹⁹⁸ See I.R.C. § 1400Z-2(b)(2)(B)(iii).

basis increase because it cannot be held for at least seven years before December 31, 2026, when all deferred gains are required to be recognized by the taxpayer.¹⁹⁹ Thus, investors in decertified QOFs, including those who seek to participate in the tax deferral and reduction benefits of another QOF investment made in the wake of a former QOF's decertification, may pay a price because certain features of the QOZ program may not be available from a new investment in a QOF. These currently include both the ten percent basis step-up available after a five-year QOF holding period reached before the end of the deferral period on December 31, 2026, as well as the additional five percent basis step-up (for a total of fifteen percent) available after a seven-year QOF holding period reached before the end of 2026.²⁰⁰

2. Consequences to the Voluntary Decertification of the Fund

The instructions for Form 8996 require the QOF to disclose whether any investor disposed of, in part or in whole, their equity interest in the fund.²⁰¹ Because the QOF's decertification results in a deemed disposition of each investor's qualifying investment in the QOF for purposes of the QOZ program, the decertified QOF generally must provide a statement with each investor's name, the date of disposal, and the interest that the investors transferred during the QOF's tax year (i.e., their entire remaining interest in the fund) during the year in which the decertification becomes effective.²⁰²

Further, when a taxpayer disposes of an investment in a QOF, the fund manager for the QOF should generally cause the QOF to file IRS Form 1099-B, *Proceeds from Broker and Barter Exchange Transactions*.²⁰³ The requirement to file Form 1099-B applies, regardless of whether the QOF is a broker or barter exchange, and in this sense, effectively eliminates various exceptions for reporting available to persons other than QOFs not falling within the definition of a "broker," a "barter exchange" or a limited number

¹⁹⁹ See I.R.C. § 1400Z-2(b)(2)(B)(iv) (requiring a seven-year holding period for the additional five percent basis increase, based on the amount of the taxpayer's original tax-deferred investment in the QOF).

²⁰⁰ See I.R.C. § 1400Z-2(b)(2)(B)(iii) (requiring a five-year holding period before the end of the deferral period for the ten percent basis step-up); I.R.C. § 1400Z-2(b)(2)(B)(iv) (requiring a seven-year holding period before the end of the deferral period for the total fifteen percent basis-step up); I.R.C. § 1400Z-2(b)(1)(B) (establishing a December 31, 2026, end of the deferral period for investors in a QOF). Note that there are proposals in Congress to extend the deferral period until 2029, making some of these basis step-ups available to new QOF investors (including those who invest gain from decertified QOFs). See H.R. NO. 117-7467 (2022); S. REP. NO. 117-4065 (2022) (proposing to amend I.R.C. § 1400Z-2(a)(2)(B) by striking "December 31, 2026." and inserting "December 31, 2029").

²⁰¹ I.R.S. Instructions for Form 8996, at *4 (Dec. 2021).

²⁰² I.R.S. Form 8996, Qualified Opportunity Fund, Part I, Line 5, at *1 (Dec. 2021).

²⁰³ I.R.S., 2022 Instructions for Form 1099-B, at *1 (May 5, 2021).

of other financial intermediaries required to file Form 1099-B.²⁰⁴ QOF fund managers should not assume that because they fall into a specific exception to information reporting in other capacities, they will be exempt from filing Form 1099-B.²⁰⁵

In general, each QOF is responsible for filing Form 1099-B for each taxpayer who disposed of an investment in a QOF, including taxpayers not electing deferral on Form 8949 under § 1400Z-2(a)(1)(A).²⁰⁶ For the year in which a QOF decertifies, each taxpayer is deemed to have disposed of its investment in the QOF for purposes of the requirement that the QOF file Form 1099-B with respect to its divesting investors. All QOFs reporting a disposition of an investment in the entity must check new box 3 on the revised Form 1099-B.²⁰⁷

If the QOF is a broker or barter exchange, it must complete the entire Form 1099-B for all dispositions of QOF investments, including, but not limited to, taxpayers electing the tax deferral and reduction potential of the QOZ program, and must follow the specific instructions for brokers or barter exchanges (for example, the reporting of basis for a QOF investment that is a covered security).²⁰⁸ The precise scope of the reporting may depend on the nature of the interest disposed. For example, if the QOF investment is stock, the QOF that is a broker or barter exchange must complete box 1e to report cost or other basis.²⁰⁹ In addition, the QOF must check the QOF box in box 3 for all dispositions of QOF investments.²¹⁰

If a QOF is not a broker or barter exchange and does not know that a broker or barter exchange reported a disposition of a QOF investment, then it must still file a separate Form 1099-B for each such disposition, although such a QOF may report less information than would otherwise be required on the form, including by completing the following items on the form:

Box 1a of Form 1099-B. For interests in the QOF, disposed of by reason of the decertification, the QOF must enter the appropriate description. For example, for investments in a QOF corporation, the QOF would enter the number of shares of stock held by each respective investor. For investments in a QOF partnership, the QOF would enter the percentage of investment held by each respective investor.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ I.R.S., Instructions for Form 1099-B, at *1 (May 5, 2021).

²¹⁰ *Id.*

Box 1b of Form 1099-B. If the QOF knows the acquisition date of any equity interest in the QOF held on the date the decertification becomes effective, the QOF must enter such date.

Box 1c of Form 1099-B. In the case of a decertification of the QOF, the QOF must enter the date on which the decertification becomes effective as the disposition date of any remaining interest in the QOF held by an investor on that date.

Box 3 of Form 1099-B. The reporting entity must check the “QOF” box for reporting the disposition of an interest in the QOF with respect to each Form 1099-B filed in connection with the deemed disposition that occurs on the QOF’s decertification date.²¹¹

QOFs must report all dispositions of QOF investments, regardless of the identity of the person who disposed of it, in the year in which the QOF decertification becomes effective.²¹² For example, if the person is a corporation, QOF fund managers should still file a Form 1099-B. For this purpose, a “disposition” includes any sale, exchange, gift, devise, inheritance, or other transfer of the QOF investment, whether the disposition is for consideration, including, for this purpose, a deemed disposition that occurs under the QOZ rules when a corporation or partnership elects to decertify (or is involuntarily decertified) as a QOF.²¹³ Each disposition must be reported on a separate Form 1099-B, regardless of how many dispositions any one person has made in the calendar year.²¹⁴ Consequently, exceptions to individualized reporting of transactions that would otherwise be available to brokers and barter exchanges are inapplicable to dispositions that must be reported by a QOF.²¹⁵ Each QOF fund manager should provide a statement reflecting the information reported to the IRS to the person who disposed of the interest in the QOF.²¹⁶

III. CONCLUSION

An updated Form 8996 for QOFs, when that is released with instructions relating to decertification, should provide investors in QOFs that are considering exiting their investment in opportunity zone projects

²¹¹ *Id.*

²¹² See Treas. Reg. § 1.1400Z2(b)-1(c)(15) (2017); I.R.S., Instructions for Form 1099-B, at *1 (May 5, 2021).

²¹³ Treas. Reg. § 1.1400Z2(b)-1(c)(15) (2017) (describing the decertification of a QOF, whether voluntary or involuntary, as an inclusion event, with respect to which deferred gain is recognized for federal income tax purposes).

²¹⁴ I.R.S., Instructions for Form 1099-B, at *1 (May 5, 2021).

²¹⁵ *Id.*

²¹⁶ *Id.*

substantially greater certainty than they have now with respect to the time, form, and manner of decertifying an investment vehicle as a QOF. While the final regulations released in mid-December 2019 provided taxpayers seeking to avoid penalties on self-certified QOFs a potential option in decertification to avoid termination of the entity for federal income tax purposes, that option requires an IRS form and instructions to become effective.²¹⁷

Taxpayers who had been waiting for more information about decertification of QOFs under section 1400Z-2 appeared to have received a check-the-box mechanism by which voluntary decertification could occur in a draft Form 8996, and instructions thereto, released in November 2020. But since check-the-box decertification never made it into the final Form 8996 for 2021 or any subsequent tax year, those looking to self-decertify QOFs in the wake of the COVID-19 pandemic and the concomitant economic uncertainty surrounding many sectors of the economy have been left in limbo for two and a half years since the IRS and Treasury Department purported to make self-decertification of a QOF a means of avoiding penalties under Treasury Regulation section 1.1400Z2(d)-1(a)(3) (Self-decertification of a QOF). As discussed, under that regulation, “[i]f a QOF chooses to self-decertify as a QOF, *the self-decertification must be effected 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* (see [Treas. Reg.] §§ 601.601(d)(2) and 601.602 of this chapter).”²¹⁸ QOFs and their investors hope that the IRS, in its next iteration of Form 8996, either adopts the check-the-box mechanism for self-decertification set forth in the November 2020 draft form or provides some other instructions and guidance to taxpayers as to how a QOF may be decertified.

²¹⁷ See Treas. Reg. § 1.1400Z2(d)-1(a)(3) (2017).

²¹⁸ *Id.*

