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Please Address Reply to:

Executive Director
DEBORAH O. McKINNON

December 27, 2018

CC:PA:LPD:PR (REG-115420-18), Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station,
Washington, DC 20044

Submitted electronically at www.regulations.gov

Re: Treasury Notice 83 Fed. Reg. 54279 (10/29/18): Comments on Proposed Regulations on Qualified Opportunity Funds under Code Section 1400Z-2

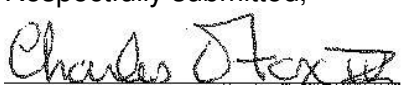
Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit the enclosed comments pursuant to Treasury Notice 83 Fed. Reg. 54279, published in the Federal Register on October 29, 2018. ACTEC commends Treasury and the IRS for their efforts in quickly drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations. ACTEC's comments focus primarily on the application of the proposed regulations to trusts and estates.

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

If you or your staff would like to discuss the comments, please contact Kevin Matz, who led the task force that put together the comments, at (212) 806-6076 or kmatz@stroock.com, Beth Shapiro Kaufman, Chair of the ACTEC Washington Affairs Committee, at (202) 862-5062 or bkaufman@capdale.com, or Deborah McKinnon, ACTEC Executive Director, at (202) 684-8460 or domckinnon@actec.org.

Respectfully submitted,



Charles D. Fox IV, President

Attachments

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

Treasury Notice 83 Fed. Reg. 54279 (10/29/18) requested comments on proposed regulations issued under section 1400Z-2 of the Code concerning qualified opportunity funds ("QOFs").[1] ACTEC commends Treasury and the IRS for their efforts in quickly drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations.[2] These comments focus primarily on the application of the proposed regulations to trusts and estates.

BACKGROUND

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

1. The deferral of gain on the disposition of property to an unrelated person until the earlier of the date on which the subsequent investment is sold or exchanged, or December 31, 2026, so long as the gain is reinvested in a QOF within 180 days of the property's disposition;

2. The elimination of up to 15% of the gain that has been reinvested in a QOF provided that certain holding period requirements are met;[3] and

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

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

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[1] Unless otherwise stated, references herein to "section(s)" or to "Code" are to the Internal Revenue Code of 1986, as amended. References herein to "§" are to relevant sections of the Treasury regulations.

[2] The proposed regulations can be found at the following link: https://www.federalregister.gov/documents/2018/10/29/2018-23382/investing-in-qualified-opportunity-funds

[3] This is accomplished through basis adjustments. Section 1400Z-2(b)(2)(B)(iii) provides that in the case of any investment in a QOF that is held for at least five years, the basis of such investment shall be increased by ten percent (10%) of the deferred gain. In addition, section 1400Z-2(b)(2)(B)(iv) provides for an additional five percent (5%) increase in the basis of the QOF investment if it is held by the taxpayer for at least seven years.

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

To become a QOF, the entity self-certifies itself. The entity must meet certain requirements, in particular a general requirement that at least 90% of its assets be "qualified opportunity zone property" used within an Opportunity Zone, but no approval or action by the IRS is required. To self-certify, the entity completes Form 8996, and then attaches that form to the entity's timely-filed federal income tax return for the taxable year (taking into account extensions).[4]

On October 19, 2018, the U.S. Department of Treasury and the Internal Revenue Service announced proposed regulations on QOFs that were released in the Federal Register on October 29, 2018.

DISCUSSION

1. Clarification should be provided concerning the income tax consequences resulting from the death of a taxpayer who has deferred gain through a timely reinvestment of gain in a QOF, and to provide relief for successors-in-interest

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

Section 691

Section 691 sets forth the rules that apply to a person's receipt of income in respect of a decedent ("IRD"). IRD refers to income earned by a decedent who was a cash basis taxpayer prior to his or her death, but that is not properly includible in income until after the decedent's death. IRD is not reportable on the decedent's final income tax return. Rather, it is reportable by the recipient of the IRD item (e.g., by the decedent's estate or some other person).[5]

Since items of IRD are subject to both income and estate taxes, the recipient is allowed an income tax deduction for the proportionate share of the estate tax (and generation-skipping transfer ("GST") tax) attributable to the IRD item.[6] This deduction mitigates, to some extent, the burden of double taxation.

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[4] Drafts of the IRS Form 8996 and the instructions thereto are set forth at the following links: https://www.irs.gov/pub/irs-dft/f8996--dft.pdf and https://www.irs.gov/pub/irs-dft/i8996--dft.pdf

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

[6] *See* section 691(c).

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

Analogous to those rules relating to income in respect of a decedent is section 691(b), which addresses deductions and credits in respect of a decedent -- which are incurred prior to death but are not properly allowable until after death.[7] Because the deductible payments would have reduced the decedent's taxable income and payment would have reduced the decedent's gross estate for estate tax purposes, deductions in respect of a decedent are excepted from the section 642(g) limitation that denies an income tax deduction if an estate tax deduction is allowed for the same item postmortem.[8]

Certain transfers of the right to receive income in respect of a decedent cause an acceleration of the income represented by that right.[9] Includible in the transferor's gross income for the taxable year of the transfer is the greater of the amount of any consideration received for the transfer or the fair market value of the right at the time of the transfer. Some transfers are excepted: for example, transfers by the decedent's estate to any beneficiary to whom the right was specifically bequeathed or as part of the residue passing to a residuary beneficiary are not acceleration events[10] and distributions by a trustee in similar circumstances presumably should be accorded similar treatment (although the law is unclear on this).[11] On the other hand, certain distributions are sure to trigger acceleration: for example, distributions in satisfaction of pecuniary bequests are acceleration events,[12] and an estate beneficiary who receives the right to income in respect of the decedent in a nonaccelerating distribution will cause an acceleration by making a gift of the right to a third party.[13]

Application of Section 691 to QOFs

The application of these rules to QOFs would seem to be as follows. Suppose that D has a $2,000,000 capital gain on April 1, 2019 and timely reinvests it in QOF on July 1, 2019. D then dies four years later – on July 1, 2023. At the time of D's death, D's interest in the QOF is worth only $100,000. D's Will gives his interest in the QOF to his child, C, as part of the residue of the estate. On December 31, 2026, the interest in the QOF is worth $500,000.

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

[8] See section 642(g) (last sentence).

[9] Section 691(a)(2).

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

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

[12] Section 691(a)(2).

[13] Treas. Reg. § 1.691(a)-4(a) (penultimate sentence).

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

> **1400Z-2(b)(2) AMOUNT INCLUDIBLE.—**
>
> **1400Z-2(b)(2)(A) IN GENERAL.—** The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of—
>
> **1400Z-2(b)(2)(A)(i)** the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over
>
> **1400Z-2(b)(2)(A)(ii)** the taxpayer's basis in the investment.

Taking this special rule into account, it would appear that D's disposition under his Will of his interest in the QOF to C as part of the residue of the estate should not trigger the inclusion of income. ***But what happens on December 31, 2026?*** It would appear that at that point C would recognize the income of $500,000, which is the amount of deferred gain capped at the fair market value of the investment in the QOF at that time. ***However, C may or may not have the liquidity necessary to pay the deferred tax that becomes due at that time. This could be particularly problematic to C if the fund does not contain redemption provisions, or if a secondary market for the interest in the fund has not matured.***

One possible approach to help mitigate this potentially serious liquidity concern of a beneficiary could be to give the successor-in-interest upon the taxpayer's death (including the personal representative of the decedent's estate) the ability to elect to treat the taxpayer's death as a recognition event for income tax purposes. In accordance with the principles set forth in Rev. Rul. 86-72[14] and *Estate of Frane v. Commissioner*,[15] the income would be properly reported by the decedent's estate on its Form 1041 fiduciary income tax return, and not on the decedent's final Form 1040 individual income tax return.[16] This solution, however, is not without its own potentially significant complications, as the successor-in-interest may be a fiduciary with a duty of impartiality with respect to all of the beneficiaries of the decedent's estate. In addition, the fiduciary may itself be a beneficiary of the decedent's estate, and potentially could stand to benefit from the consequences of any such election. So although there may be some appeal to providing such a solution on behalf of the successor-in-interest, it may be too problematic, all things considered.

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[14] 1986-1 C.B. 253. In this Revenue Ruling, the IRS held that installment obligations that self-canceled upon the seller's death were treated as transfers that triggered the section 691(a)(2) income acceleration rule, and the outstanding gain was recognized by and includible in the gross income of the seller's estate.

[15] 98 T.C. 341 (1992), *aff'd in part and rev'd in part*, 998 F.2d 567 (8th Cir. 1993).

[16] In *Frane*, the United States Court of Appeals for the Eighth Circuit held that cancellation of a self-canceling installment note was an income taxable event, and further ruled that the income is properly reported by the decedent's estate on its Form 1041 fiduciary income tax return, and not on the decedent's final Form 1040 individual income tax return.

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

We further request that clarification be provided confirming that a taxpayer's death does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or more years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

2. Clarification should be provided concerning the income tax consequences resulting from the gift of an interest in a QOF where the donor has deferred gain through a timely reinvestment of gain in a QOF

Similarly, clarification is needed concerning the income tax consequences that result from a gift of an interest in a QOF.

Section 1400Z-2(b) provides for the deferral of gain that is invested in opportunity zone property until the earlier of the date on which such investment is sold or exchanged, or December 31, 2026. A gift of an interest in a QOF is generally neither a sale nor an exchange.[17] Accordingly, we respectfully request that clarification be provided to confirm that a gift of an interest in a QOF should not be considered a sale or exchange for purposes of section 1400Z-2(b), provided that the gift is not otherwise treated by the tax law as a taxable disposition for income tax purposes.

We further request that clarification be provided to confirm that such a gift does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or more years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

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

Clarification is requested concerning grantor trusts, specifically with respect to the income tax consequences that would result from a transaction between a grantor and a grantor trust where Rev. Rul. 85-13[18] would otherwise cause it to be a non-recognition event for income tax purposes.

The grantor trust rules are set forth in sections 671 through 679. These rules generally provide that if certain rights or powers are retained, the grantor (or other individual treated as the "owner" for income tax purposes) will be required to include all (or a portion) of the gains, losses, deductions and credits attributable to the trust on his or her own personal income tax return. In

[17] An exception to this general rule could apply, for example, if the donor's interest in the QOF is encumbered by debt in excess of basis.

[18] *See* Rev. Rul. 85-13, 1985-1 C.B. 184.

accordance with the grantor trust rules, it should not matter whether the gain that is sought to be deferred, or the funds that are subsequently invested in the QOF, belong to the taxpayer or to such taxpayer's grantor trust. We accordingly request clarification to this effect.

In addition, pursuant to Rev. Rul. 85-13, transactions between a grantor and such person's grantor trust are disregarded for federal income tax purposes. Accordingly, a sale (or other transaction[19]) of an interest in a QOF between a grantor and such person's grantor trust should not be considered a sale or exchange of an interest in a QOF, and therefore should not trigger the recognition of gain. We request that this be confirmed as well.

We further request that clarification be provided to confirm that transactions between a grantor and such person's grantor trust does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or more years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

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

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

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

- First, the proposed regulations include special provisions by which gain recognized by a partnership may flow through to the partners and be reinvested by the partners in a QOF (except to the extent the partnership elects to rollover the gain itself).[20]

- Second, there is the potential for partners to have an increased period during which to reinvest gain in a QOF. The partnership's 180-day period begins on the date of its sale, but if the gain flows through to the partners, the partners' 180-day period generally begins on the last day of the partnership's taxable year.[21]

The proposed regulations state that rules analogous to the partnership and partner guidance indicated above apply to other pass-through entities (including S corporations, decedents'

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[19] The "other transaction" could include the exercise of a so-called "swap power" described in section 675(4)(C) to reacquire the trust corpus by substituting other property of an equivalent value, where such power is exercisable in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity.

[20] Prop. Reg. §1.1400Z-2(a)-1(c)(2).

[21] Partners may instead elect to use the partnership's 180-day period if they so desire (e.g., if the desired investment is already lined up). *See* Prop. Reg. §1.1400Z-2(a)-1(c)(2)(iii)(B).

estates, and trusts) and to their shareholders and beneficiaries.[22] In addition, the preamble to the proposed regulations requests comments concerning whether taxpayers would benefit from further clarification in the context of S corporations, decedents' estates and trusts.

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

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

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

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

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

Suppose that X Estate is a calendar year estate that has $5 million of capital gains during the year ending December 31, 2018, which it distributes to Y (a beneficiary of X Estate) on February 28, 2019. The estate elects under section 663(b) to treat this distribution of capital gains as having been made by the estate on December 31, 2018 and further elects to treat this distribution as carrying out to Y distributable net income (DNI) under section 643(a). X Estate timely extends the due date for filing its Form 1041 fiduciary income tax return and eventually files its 2018 Form 1041

[22] Prop. Reg. §1.1400Z-2(a)-1(c)(3).

with the Internal Revenue Service on September 1, 2019 and mails out its Schedule K-1 to Y, who receives it on September 5, 2019. Y timely files her 2018 individual income tax return on October 1, 2019, and her tax return does not contain an election to rollover gain to a QOF.

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