

## **NEW IRS FAQ PERMITS SECTION 1231 GAINS INVESTED IN A QOF DURING 2018 TO BE A QUALIFYING INVESTMENT**

The second round of proposed regulations states that Section 1231 capital gains can only be available for investment in a QOF to the extent of the 1231 net capital gain amount and that the period for investment commences on the last day of a tax year. A recent updated IRS FAQ provides relief for certain 2018 Section 1231 capital gain. In general, Section 1231 property is depreciable property and real property used in a business, but does not include land held for investment

The special rule regarding Section 1231 gains raised a series of questions:

1. What about 2018 Section 1231 capital gains that were invested in a QOF within 180 days immediately after the resulting sale and gain recognition date? (Addressed by new IRA FAQ).
2. What about 2018 gross Section 1231 capital gains that were already invested in a QOF prior to the second round of guidance?
3. Do these limitations apply to 2019 Section 1231 capital gains that were recognized and invested in a QOF prior to the second round of proposed regulations?
4. Will an exception be developed to allow Section 1231 capital gains in 2019 and future years to be invested within 180 days following the sale and gain recognition date?

On June 24, the IRS Opportunity Zones FAQs added a Q/A that addressed the first two of these questions. An investment in a QOF and an OZ deferral election can be made for the Section 1231 gross amount “realized” during the 2018 tax year invested in a QOF within 180 days after such sale date and during the 2018 tax year, but only to the extent that the 1231 gross amount recognized on such sale date does not exceed the Section 1231 net amount for the 2018 tax year. The exception was provided for Section 1231 capital gain during the 2018 tax year because the second round guidance was published in the Federal Register on May 1, 2019. The text of the FAQ can be found at (<https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>). An amended 2018 tax return might be necessary.

It is helpful to Section 1231 capital gain amounts that fit within this exception that have already been invested in QOF, and for which tax returns might have already been filed, but the exception leaves some situations open:

- a. Is the exception totally unavailable if the taxpayer invests the 2018 Section 1231 gross capital gain amount and such amount exceeds the 2018 Section 1231 net capital gain amount? Alternatively, is the excess amount considered a nonqualifying investment that requires immediate taxation of such excess amount and a dilution of the tax free appreciation available?
- b. Although the normal rule provides 180 days from the sale date, the special rule with respect to 2018 Section 1231 capital gain is limited to investments in a QOF within 2018.

- c. Investment in an QOF starting on the last day of the year or the remaining period in the 180-day period that extends into 2019 is already available pursuant to the second round guidance.
- d. If the Section 1231 gain amount was recognized during the second half of 2018 and the QOF investment was made during the first few months of 2019 (before the April 2019 IRS guidance was issued), the IRS FAQ does not provide any relief.
- e. If the facts permit, to the extent that the QOF tax return has not been filed and no QOF election made, can the transaction be unwound and the capital gain investment be made by June 29 to fit within the basic rule that the 180-day clock starts on the last day of the tax year?
- f. The FAQ references the 180-day start date on the “realization” of the Section 1231 gain. This touches on a question of whether the 180-day period commences when the gain is recognized, as stated by the first round of the proposed regulations, or from the sale date, as stated in the statute. If the Section 1231 gain is recognized on the installment method, then such gain would seem to be subject to the Section 1231 net gain rule stated in the second round guidance.
- g. For now, the added Q/A does not change the second round guidance that the start date of the 180-day period to invest Section 1231 net capital gains that arise in 2019 and future years is the last day of such tax year. Comments have been submitted regarding this point.

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