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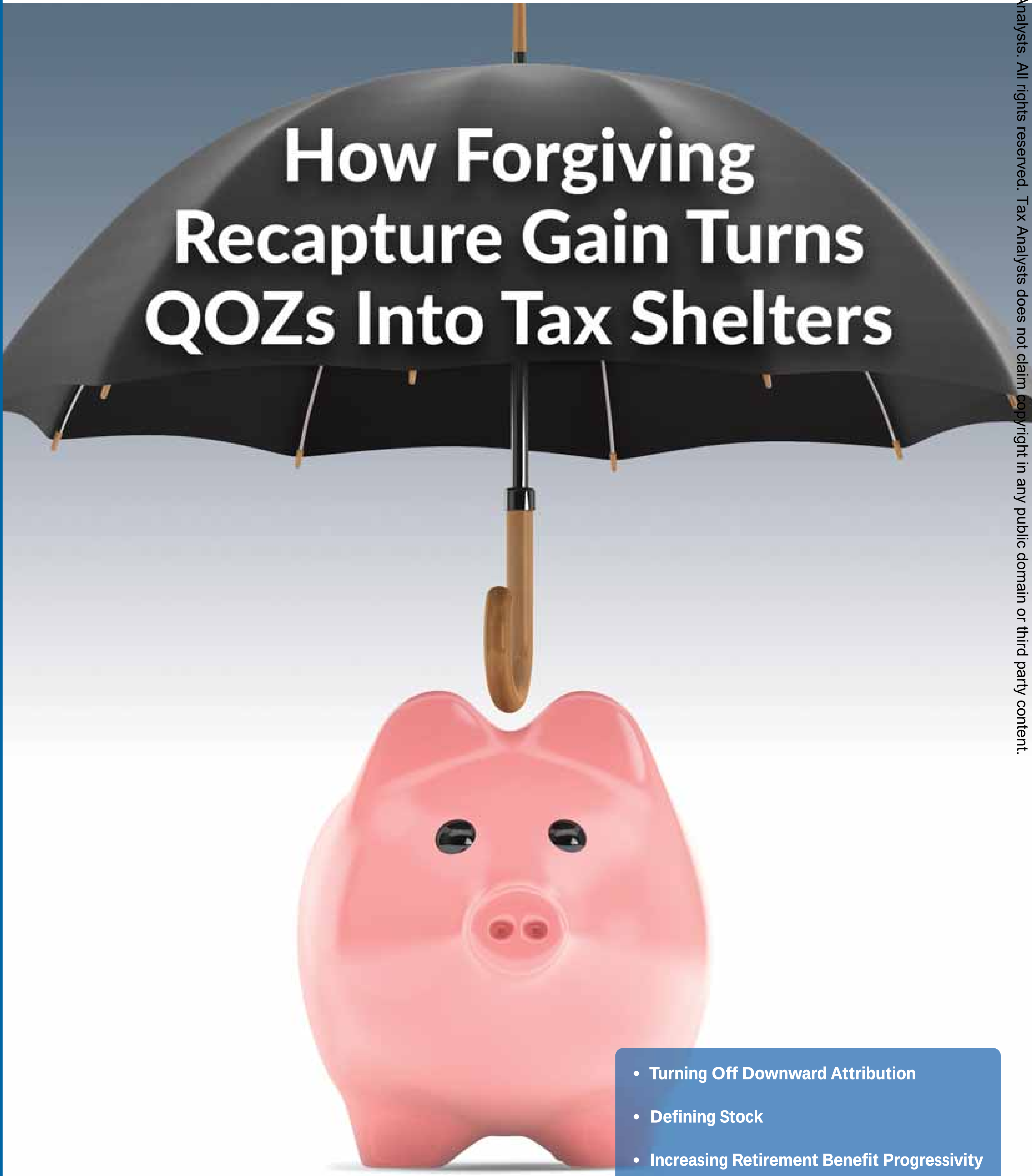
How Forgiving Recapture Gain Turns QOZs Into Tax Shelters



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Regs Aren't Supposed to Pit Treasury Against Congress

Ariel S. Greenblum

Qualified Opportunity Zones and the windfall they could provide to investors continue to discomfit Congress (p. 1359), perhaps for good reason. Andrew Gradman describes how the government's forgiving recapture gain upon the sale of an interest in a qualified opportunity fund would bestow an unwarranted tax benefit on investors (p. 1295). Treasury's adoption of that stance in proposed regulations ignores Congress's chosen mechanism for realization of investor tax benefit (basis) and prior proposed regulations, which specify that basis refers to adjusted basis. Gradman distinguishes between investment in places and people and urges Congress to do the same.

Marie Sapirie considers the downward attribution rules in yet another example of Treasury's acting against Congress (p. 1261). But while some taxpayers welcome the relief offered by newly reinstated section 958(b)(4), Sapirie emphasizes that the proposed regs do the opposite of what the statute (or lack thereof) said. She also cites prior instances of when Congress permitted Treasury to contradict code provisions.

Walter Schwidetzky examines the proposed regs that apply section 163(j) to partnerships, pardoning Treasury for its lengthy interpretation of the tortuous code section because of its provision of partner-partnership interest deduction parity (p. 1269). He analyzes the regs' 11 consecutive calculations, beginning with a partnership determining its section 163(j) limit and ending with allocating excess items in section 163(j) (such as excess business interest income) to partners. Schwidetzky gives special attention to the warning in the eighth calculation, which turns on the word "inequitable."

Schwidetzky praises Treasury's effort in actualizing section 163(j), but suggests that the regs' complexity will be their downfall. He offers a few alternatives, including the disallowance of partnerships breaking down ATI and allocating its segments separately. Another of his recommendations involves examining the purpose of the statute and going from there. Benjamin Willis conducts a similar analysis for defining stock, arguing that the purpose of individual code provisions should be scrutinized in determining whether to hold entities liable (p. 1309). *Himmel* addresses the rights commonly associated with stock, but it's not definitive because so many different legal entities — life insurance companies and savings and loan associations, for example — can be subject to corporate provisions, he writes.

Could statutory purpose help clarify how to offer more targeted Social Security and Medicare benefits? Sita Slavov and Alan Viard present a way to make them more progressive, while also retaining them (p. 1313). They argue that awarding those benefits based on lifetime earnings would achieve those goals, and they outline a computation of lifetime earnings. Included would be earnings subject to Social Security tax, as well as earnings subject to the Medicare tax. ■

How Forgiving Recapture Gain Turns QOZs Into Tax Shelters

by Andrew Gradman

Andrew Gradman is an associate at Givner & Kaye. He thanks Luis Bacalao, Peter Mitchell, Fred Muller, Daniel N. Shaviro, William Staley, Michael Wiener, and Greg Zbylut for their comments.

In this article, Gradman argues that Treasury's proposal to forgive recapture when qualified Opportunity Zone investments are sold creates a tax shelter, which is contrary to both the statutory text and the policy goals of the zones.

As part of the Tax Cuts and Jobs Act, Congress passed subchapter Z, creating tax benefits for taxpayers that make qualifying investments in special entities (funds) doing business in distressed communities (qualified Opportunity Zones (QOZs)). One benefit is that if an investor sells a fund after 10 years, "the basis of such property shall be equal to the fair market value of such investment" on the date of the sale (the step-up to FMV).[1]

The step-up to FMV has the effect of forgiving gain from the sale. The question is, how much gain? In proposed regulations, Treasury indicated that it would extend this forgiveness to gain attributable to prior accelerated depreciation (recapture gain). However, I argue that the statute does not permit that step-up, but permits only stepping up gain attributable to an increase in the FMV of the fund (economic gain).

I also argue that forgiving recapture gain would turn QOZs into an unwarranted, and unintended, shelter for ordinary income. Because recapture is not correlated with economic success, it is easy to manipulate without advancing the statute's goals. With simple planning, and with little impact on the economic well-being of QOZ communities, an investor can convert a large portion of his initial capital contribution into deductions that he can use to shelter his nonpassive income.

With the passage of the passive loss limitation, "the last tax shelter wars . . . ended abruptly in a sweeping government victory."[2] Treasury's proposed regulations would resurrect these wars. If Congress wants to make QOZs more generous, it should focus instead on the principles that inspired them: rewarding economic gain and encouraging investments traceable to the sale of non-QOZ assets.

I. The TCJA Forgives Economic Gain Only

A. Two Ambiguities in the TCJA

QOZs were the idea of the Economic Innovation Group. In 2015 the think tank published a paper titled "Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas,"[3] then worked with Congress to

[1] Section 1400Z-2(c).

[2] Marvin A. Chirelstein and Lawrence A. Zelenak, "Tax Shelters and the Search for a Silver Bullet," 105(6) *Colum. L. Rev.* 1939, 1951-1952 (2005).

[3] Jared Bernstein and Kevin A. Hassett, "Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas," Economic Innovation Group (Apr. 2015) (EIG White Paper).

write the first version of the QOZ statute,[4] the Investing in Opportunity Act of 2016 (IIOA).[5] The IIOA described the benefit arising at the 10th year this way:

> Section 1400Z-2(a)(3): Exclusion of Gain of Qualified Opportunity Zone Property Held for at Least 10 Years. . . . In the case of the sale or exchange of qualified opportunity zone property, or an investment in a qualified opportunity fund, held for at least 10 years, *gross income for the taxable year shall not include any gain from the sale* or exchange of such property or investment. [Emphasis added.]

Had Congress kept this language, the argument for forgiving recapture gain would have been stronger; the IIOA stated that the taxpayer would not recognize "any gain from the sale." However, as part of the TCJA, Congress rewrote this provision as follows:

> Section 1400Z-2(c): Special rule for investments held for at least 10 years. In the case of any investment held by the taxpayer for at least 10 years and with respect to which the taxpayer makes an election under this clause, *the basis of such property shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged*.

> Section 1016(a): Proper adjustment in respect of the property shall in all cases be made . . . (38) to the extent provided in . . . [1400Z-2(c)]. [Emphasis added.]

The enacted law differs from the IIOA in two relevant ways.[6] First, the IIOA expressly provided for elimination of all gain; in the TCJA, this became a basis step-up (that is, the step-up to FMV). Second, the TCJA codified this basis step-up as one of the adjustments to basis in section 1016(a).

Neither provision in the TCJA clearly says whether recapture gain should be forgiven. First, in section 1400Z-2(c), Congress simply provided for stepping up "the basis" without specifying whether "basis" means the unadjusted basis or the adjusted basis.[7] The distinction matters: Unadjusted basis refers to the cost or other basis described in section 1011(a), before the adjustments in section 1016(a). Thus, using this term would have meant that the step-up to FMV occurs before these adjustments — and in particular, before the adjustment for depreciation — so that recapture gain would not be forgiven. Adjusted basis does incorporate those adjustments, and so would have meant that recapture gain is forgiven.

Second, in describing the step-up to FMV as an adjustment to basis, Congress failed to address a unique feature of the step-up. Unlike all the other adjustments in section 1016, which involve addition or subtraction, the step-up to FMV is, literally, a step-up. Thus, order matters. If performed last (after the adjustment for depreciation), recapture gain would be forgiven; if performed first (before the adjustment for depreciation), recapture gain would not be forgiven.

B. TCJA Does Not Forgive Recapture

The April 2019 proposed regulations resolve the ambiguity by interpreting "basis" to mean "adjusted basis." Specifically, they state that the step-up to FMV should be "calculated in a manner similar to a section 743(b) adjustment," which references the adjusted basis.

It is unclear how Treasury reached this decision. However, three months earlier, in footnote 54 of a 54-page letter to Treasury discussing prior proposed regulations, the American Bar Association Section of Taxation

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[4] John Lettieri, "Testimony Before the U.S. Senate Committee on Small Business and Entrepreneurship" (Oct. 3, 2018) ("EIG was deeply involved in the development of the [IIOA], which garnered broad bipartisan support and served as the basis of the Opportunity Zones provision in the TCJA.").

[5] S. Rep. No. 2868 (2016); and H.R. 5082, 114th Cong. (2016). Identical legislation was introduced in the next Congress. S. 293, 115th Cong. (2017); and H.R. 828, 115th Cong. (2017).

[6] A third distinction, beyond the scope of this article, is that while the IIOA expressly provided relief to both entity sales and asset sales, the TCJA describes only entity sales.

[7] *See* James Edward Maule, "Income Tax Basis: Overview and Conceptual Aspects (Portfolio 560)," Bloomberg Tax and Accounting ("A person who refers to 'the taxpayer's basis in the property' may intend to refer to adjusted basis or to the basis without regard to adjustments, and a person hearing that reference may give the same or the opposite meaning to what is intended. Explicit reference to 'adjusted basis' and 'unadjusted basis' clarifies what is intended to be communicated.").

argued that Congress meant for recapture gain to be forgiven. It wrote:

> Our belief that the step-up can eliminate depreciation recapture in this context (i.e., where losses claimed do not exceed the taxpayer's equity investment) is based upon the plain language of the statute. If Congress had intended to grant a step-up only in an amount equal to the economic appreciation in value between the date of acquisition and the date of sale, they could easily have said that. But the language they used was a step-up to fair market value which clearly goes further. It is hard to believe that Congress didn't appreciate the difference between these two concepts; but if that is the case, we believe that the fix to the very clearly statutory language should be made by Congress, not Treasury and the Service.[8]

These arguments are not persuasive. First, the argument that "they could easily have said that" runs both ways: If Congress wanted to forgive recapture gain, it could have amended sections 1245(b) and 1250(d) to say that; these sections provide that recapture gain shall not occur at death, gift, or a section 1031 exchange, but say nothing about QOZs. Similarly, if Congress wanted to say that "gross income for the tax year shall not include any gain from the sale or exchange of such property or investment," it could have not deleted this language from the IIOA.[9]

The ABA tax section also noted that "the language [Congress] used was a step-up to fair market value." That is true, but incomplete. A step-up has two components: the thing stepped up, and the place it is stepped up to. As noted, the ambiguity lies in the former term — that is, whether the thing stepped up is the adjusted basis or the unadjusted basis.

On closer inspection, the TCJA favors stepping up the unadjusted basis. While the word "basis" may be ambiguous when taken out of context, the surrounding language offers a clue: It is the language that the code traditionally uses when setting forth an unadjusted basis. Compare these examples:

- Section 1400Z-2(c): "The basis of such property shall be equal to the fair market value of such investment."
- Section 1012: "The basis of property shall be the cost of such property."
- Section 1014(a): "The basis of property [shall be] the fair market value of the property."
- Section 1015(a): "The basis shall be such fair market value."
- Section 301(d): "The basis of property received in a distribution . . . shall be the fair market value of such property."

Thus, while the statute is not explicit, the evidence supports stepping up the unadjusted basis and not forgiving recapture gain.

II. An Unwarranted Tax Shelter

In addition to contradicting the statute, recapture forgiveness also undermines the statute's policy goals. Because recapture is not correlated with economic success, it is easy to manipulate for private tax benefits without improving the economic well-being of QOZ communities.

A. Crane Without the 'Booby Trap'

Writing four decades ago, in a passage famous for its explanation of *Crane*'s role in leveraged tax shelters,[10] Boris I. Bittker observed that recapture is what keeps tax shelters from running amok. Although his discussion focused on leverage, which is not a major feature of QOZ tax shelters, he aptly described the importance of recapture:

> By holding that nonrecourse liabilities are includable in the taxpayer's basis for property, *Crane* laid the foundation stone

[8] *See* ABA's letter to IRS Commissioner Charles Rettig, at n.54 (Jan. 10, 2019). The letter allowed for an exception for recapture attributable to debt financing, because in this case the tax benefit would be "greater than what Congress could reasonably have expected."

[9] Arguably, the Joint Explanatory Statement (JES) to the TCJA equates the step-up to FMV with the exclusion from gross income in the IIOA; it characterizes the TCJA as "exclud[ing] from gross income the post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years." Committee of Conference JES, H.R. Rep. No. 115-466, at 400 (Dec. 15, 2017). However, the resemblance is only superficial. The JES mentions "capital gains," which are not part of the basis step-up in either the TCJA or in the IIOA. Likewise, Treasury did not limit the step-up to FMV to capital gains, so it is unlikely that Treasury relied on the JES as its authority.

[10] *Crane v. Commissioner*, 331 U.S. 1 (1947).

> of most tax shelters, while the corollary of this basis rule — that the termination of nonrecourse liability is an amount realized when the property is sold or disposed of — is the booby trap waiting for tax sheltered investors when their venture is wound up. Thus, tax shelters enable investors to deduct depreciation, drilling expenses and similar items as rapidly as the expenditures are made, even though financed by nonrecourse borrowing, hence exceeding their current cash outlay; but when the investment is sold, nonrecourse liabilities are includable in the amount realized in computing gains, *so that the deductions taken in the earlier years are — or should be — recaptured at the end of the road.*[11]

In short: When accelerated depreciation is recaptured, it is the equivalent of an interest-free loan, which must be repaid when the asset is sold. Without recapture, the loan need not be repaid.

If a person could have his debts forgiven at will, he would exercise this power when his debts were at their maximum. Similarly, if QOZs forgive recapture gain, investors should invest in enterprises whose assets recover basis quickly yet retain their value, then sell the investment when the spread between value and basis is at its maximum. Here are four ways to achieve that result.

1. Buy real estate.

Real estate, the most common QOZ investment, also happens to be a fairly effective QOZ tax shelter. An investor can generally rely on a dollar of depreciation not representing an actual diminution of value. Thus, an investor who holds a building for 10 years will eventually be able to extract either 26 or 36 percent of its original value as deductions (that is, 10/39 for nonresidential, and 10/27.5 for residential). This will be true even if the building does not appreciate and earns little rent.

2. Obtain a cost segregation study.

But real estate is not the ideal QOZ asset. It holds its value but does not depreciate quickly. A better investment for a fund is one that retains value like real estate but depreciates like personal property. For that reason, we should expect every real estate fund to obtain a cost segregation study.

Cost segregation is the process of identifying personal property associated with real property to depreciate that part of the property faster. An example from a website promoting these studies describes a nonresidential (39-year) property worth $2.25 million.[12] In the study, nearly 30 percent of this value was recharacterized as either five-year or 15-year property, including items such as moldings, carpet, communications/data, drive-through canopies, parking lots, landscaping, and flagpoles. Had all this property been treated as 39-year property, by year 10 it would have generated only $168,356 in depreciation. Thanks to the study, however, it generated an extra $360,303 in depreciation. Again, in a QOZ, this extra depreciation is never recaptured.

Note that the proposed regulations would forgive ordinary income recapture only in an entity sale, not in an asset sale.[13] Thus, to enjoy the benefit of a cost segregation study, the building must be sold as part of a sale of the fund.

3. Prefer residential rental.

Cost segregation affects only the portion of the investment that is personal property. To hasten depreciation of the real property, the investor should prefer investments in residential (27.5-year) over nonresidential (39-year) property. Residential property generates annual depreciation deductions that are 40 percent greater than those of an equivalent nonresidential property. The same is true in non-QOZ investments; however, in a QOZ investment, when recapture forgiveness is taken into account, the effect on the bottom line can be more than

[11] Bittker, "Tax Shelters, Nonrecourse Debt, and the Crane Case," 33 *Tax L. Rev.* 277 (1978) (emphasis added).

[12] Perkins Financial, "Simple Example of Cost Segregation."

[13] *Compare* prop. reg. section 1.1400Z-2(c)-1(b)(2)(ii)(A)(1) (providing an election to step up passed-through gains from asset sales but limiting the election to "capital gain"), *with* prop. reg. section 1.1400Z-2(c)-1(d)(2), Example 2 (allowing the election when the taxpayer has "gain"). Where ordinary income recapture is forgiven, inventory and other "hot assets" are eligible for step-up. *Id.*

doubled. This bias toward residential is further exaggerated as rents decrease (because accelerated depreciation represents an increasing share of total business value) and as discount rates decrease (because recapture forgiveness is a long-term benefit).

4. Use accelerated techniques.

To quickly extract basis from an asset without impairing its value, nothing beats those code sections that allow the immediate deduction of the purchase price. These include section 168(k) (bonus depreciation), section 179 (expensing election), and sections 448(c) and 263A(i) (exceptions from the accrual method and capitalization).

- Under the TCJA, bonus depreciation is expanded to 100 percent through 2022, and also applies to used assets; however, it sunsets after 2026.
- Under the TCJA, the annual limitation for the section 179 expensing election is increased to $1 million and does not begin to phase out until amounts placed in service exceed $2.5 million. The types of real property eligible for expensing have also been expanded. However, the deduction is limited to income from an active trade or business.
- Under revised sections 448(c) and 263A(i), if a taxpayer has annual gross receipts for the prior three-year period below $25 million plus inflation, it can use the cash method and is exempt from the uniform capitalization rules.

Example 1 (bonus depreciation): In 2018 X makes a qualified investment into a fund. In the same year, the fund buys depreciable personal property, places it into service, and immediately deducts the entire purchase price. In 2028 X sells the fund for its FMV. To the extent that the depreciable assets in fact retain their value, X enjoys this value as a deduction while realizing no gain. (To help ensure that the assets do retain their value, the fund could buy used rather than new assets.)

B. Circumventing the Loss Limitation Rules

The fact that a basis step-up creates a tax shelter may be surprising; this has not happened with the step-up at death. However, the step-up for QOZs is easier to exploit. First, it is elective, both in its timing and in whether to make the election at all. Second, in contrast to death, when losses do not carry over to the estate,[14] passive losses are disallowed only to the extent of recapture.[15] If there is no recapture, the losses are simply delayed until sale.[16]

This delay should be worth it. A QOZ investment could ensure that, in 10 years or more, the investor will have sufficient loss carryforwards that he never again pays taxes on his wages or IRA distributions. These deferred losses become more valuable after 2026, when the maximum tax rate rises from 37 to 39.6,[17] and even more valuable if rates rise further.[18]

Example 2 (passive investment): Same as Example 1, but X is a passive investor. When the equipment is bought and depreciated, the loss is suspended. In 2028, when the fund is sold in a fully taxable transaction, the basis is stepped up to the FMV; there is no gain, and, under section 469(g), the passive loss is released from suspension. (By contrast, in a non-QOZ, the recapture gain at sale would have absorbed the loss.)

The other loss limitation rules will also have little effect on this technique. Section 704(d), which limits a partner's deduction of partnership losses to his adjusted basis in his partnership interest, is circumvented by the basis step-up at sale. Section 465, which limits deductions from specific activities to amounts "at risk," is mainly implicated by nonrecourse debt in non-real property ventures. Finally, section 461(l) merely

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[14] Rev. Rul. 74-175, 1974-1 C.B. 52 (loss carryovers terminate at death).

[15] *See* section 469(g) (the taxpayer must fully dispose of his entire interest in the passive activity in a "fully taxable transaction" — *i.e.*, one in which "all gain or loss realized . . . is recognized").

[16] Daniel N. Shaviro, "Passive Loss Rules (Portfolio 549)," Bloomberg Tax and Accounting ("To impede such sheltering, the rules establish a category of 'suspect' activities (passive activities), the losses and excess credits from which generally cannot be used to shelter income from other types of activities (nonpassive activities). . . . The passive loss rules can be viewed, in a sense, as a 'reverse realization requirement' in favor of the government, limiting certain passive losses until their economic reality has been proven through an arm's-length exchange or other final disposition.").

[17] Section 1(j) (TCJA rates); and section 1(a) (pre- and post-TCJA rates).

[18] Rep. Alexandria Ocasio-Cortez, D-N.Y., has suggested raising the top tax rate to 70 percent. *See* Laura Davison, "Trump's Tax Cuts Could Die the Hard Way: A Little at a Time," Bloomberg, June 18, 2019.

converts losses into net operating loss carryforwards.

C. Using Leverage to Avoid Mixed Funds

Leverage is not the best way to exploit recapture forgiveness in QOZs. Although debt financing does increase the amount of recapture, it does not increase the fund's FMV; thus, the extra recapture will not necessarily be forgiven.[19]

Nevertheless, debt financing can augment the step-up to FMV if used in lieu of a nonqualifying equity investment. This is because, while nonqualifying equity dilutes the step-up to FMV by a pro rata amount, debt financing only reduces the step-up to FMV by the dollar amount of the outstanding debt.

Example 3 (mixed fund): X has $100 of eligible gain. He invests $200 into a partnership as equity. Over 10 years his ownership interest triples in value, to $600. However, under the "mixed fund" rules, only 50 percent of this equity, or $300 (($200 * 3)/2), is eligible for the step-up to FMV. If the fund buys depreciable assets, only 50 percent of the recapture gain will be forgiven.

Example 4 (avoiding a mixed fund): Same as Example 3, but X instead invests $100 and loans $100. After 10 years, X's equity is worth only $500 (($200 * 3) - $100). However, because this is not a mixed fund, 100 percent of this equity ($500) is eligible for the step-up to FMV. To reduce the risk that the IRS might recharacterize X's "loan" as equity, the fund might instead borrow from a bank.

Another advantage of debt is that it can be paid down, leaving a 100 percent qualifying investment without any debt. By contrast, a mixed fund is a mixed fund forever, no matter how distributions are made.[20]

III. Conclusion

To attack the shelters described here, the IRS may deploy several antiabuse rules. However, it will have little success. The reason is that the outcomes that the law seeks to encourage — "economic growth and investment in distressed communities"[21] — are hard to distinguish from abusive behaviors. In the words of economics Nobel laureate and *The New York Times* columnist Paul Krugman, in a column describing QOZs as a "tax scam":

> Selective tax breaks often end up mainly providing new and improved ways to dodge taxes. Rich people with smart accountants don't have a hard time pretending to be small-business owners, developers serving poor communities or whatever else the creators of those tax breaks are ostensibly trying to promote.[22]

Krugman was referring to a report in the same newspaper two days earlier that described how "billions of untaxed investment profits are beginning to pour into high-end apartment buildings and hotels, storage facilities that employ only a handful of workers, and student housing in bustling college towns."[23] However, his point is also illustrated by the tax shelters described here, which encourage rent-seeking behaviors but do little for poor communities.

Before making further changes to the QOZ statute, Congress should clarify its goals. Encouraging investment in distressed communities is not always the same thing as helping the residents of those communities.[24] If the theory behind QOZs is trickle-down economics, Congress should focus on rewarding economic gain rather than recapture gain. If the idea is to motivate investors to sell their appreciated assets, Congress might take a cue from the original proposal for QOZs. The deferral of pre-investment gain — which continues until the earlier of 2026 or the sale of the fund — might be revised to simply permit deferral until sale,

[19] The ABA tax section observes that a step-up to "net fair market value" (net of debt) can lead to inconsistent results. It recommends that the step-up instead be to "gross fair market value" (not net of debt), at least when such debt was not used to claim deductions. *See* ABA letter, *supra* note 8, at 29-33.

[20] *See* prop. reg. section 1.1400Z2(b)-1(c)(6)(iv)(B) (in a mixed fund, distributions must be made pro rata between the qualifying and nonqualifying interests).

[21] JES, *supra* note 9, at 398.

[22] Krugman, "The Great Tax Break Heist," *The New York Times*, Sept. 2, 2019.

[23] Jesse Drucker and Eric Lipton, "How a Trump Tax Break to Help Poor Communities Became a Windfall for the Rich," *The New York Times*, Aug. 31, 2019.

[24] *See* Paul McDaniel et al., *Federal Income Taxation: Cases and Materials* 1191 (2008) ("Tax shelters . . . thus highlight the problems of using the tax system not only to raise revenues to finance the costs of government but also as a mechanism through which subsidies are provided.").

which is how the Economic Innovation Group first described the idea in its 2015 paper.[25]

Taxpayers cannot yet rely on the inclusion of recapture gain in the step-up to FMV,[26] but Treasury is under pressure to allow this.[27] If that happened, the consequences would be far-reaching. Writing in 1986 of the need for the new passive loss limitation, the Senate Finance Committee wrote that "taxpayers are losing faith in the Federal income tax system," and that "the tax system itself is threatened."[28] How much truer would that be in the QOZ context, when — to paraphrase Bittker — QOZs could become the "foundation stone" for the tax shelter of the 21st century, but without the "booby trap" of recapture waiting at the other end.

■

[25] "Unrealized capital gains might be rolled over into special funds . . . with the capital gains taxed only if the money is withdrawn from the qualified funds down the road." EIG White Paper, *supra* note 3, at 18.

[26] *See* REG-120186-18 ("This pre-finalization reliance does not apply to the rules of prop. reg. section 1.1400Z2(c)-1 set forth in this notice of proposed rulemaking."). Treasury's stated reason for not permitting reliance on these rules is that they "do not apply until January 1, 2028." However, Treasury does permit reliance on other rules that will not apply until December 31, 2026, just a year earlier.

[27] *See* AICPA tax advocacy comment letter on QOZs (Sept. 10, 2019) ("QOF investors and sponsors . . . want to plan now with respect to exiting their investments and structuring their funds accordingly. Therefore, Treasury and the IRS should issue guidance permitting taxpayers to rely on the proposed regulations prior to finalization if applied consistently and in their entirety.").

[28] Finance Committee Report, Tax Reform Act of 1986, S. Rep. No. 99-313, at 713-718 (1986).