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**Reg. Section 1.1400Z2(c)-1**

Investments held for at least 10 years

(a)Scope. This section provides rules under section 1400Z-2(c) of the Internal Revenue Code regarding the election to adjust the basis in a qualifying investment in a QOF or in certain eligible property held by the QOF. See §1.1400Z2(b)-1(d) for rules for determining the holding period of a qualifying investment for purposes of this section.

(b)Investment for which an election can be made.

(1)In general.

(i) Election by taxpayer. An eligible taxpayer who makes a deferral election with respect to, or acquires by reason of a transaction that is not an inclusion event, a qualifying investment in a QOF, recognizes gain (if any) on December 31, 2026, of an amount determined under § 1.1400Z2(b)-1(e)(3) (and so much of §1.1400Z2(b)-1(e)(4) as relates to §1.1400Z2(b)-1(e)(3)) with respect to that qualifying investment, and whose holding period in that qualifying investment is at least ten years, is eligible to make an election described in section 1400Z-2(c) on the sale or exchange of that qualifying investment. Except as otherwise provided in this paragraph (b)(1), to the extent a taxpayer described in the preceding sentence has an inclusion event described in §1.1400Z2(b)-1(c) with respect to any portion of a qualifying investment, that portion is no longer a qualifying investment and the taxpayer is not eligible to make an election pursuant to section 1400Z-2(c) and this section with respect to that portion. See §1.1400Z2(c)-1(b)(2) for special election rules for QOF partnerships and QOF S corporations.

(ii) Transferee partnership to make an election under section 1400Z-2(c).

(A) In general. This paragraph (b)(1)(ii)(A) applies if an eligible taxpayer (transferor) transfers its qualifying investment to a transferee in a transaction described in §1.1400Z2(b)-1(c)(6)(ii) to the extent governed by section 721(a). If this paragraph (b)(1)(ii)(A) applies, and if the transferee sells or exchanges a qualifying investment that has a holding period of at least 10 years under §1.1400Z2(b)-1(d)(1)(ii)(F), then the transferee can make an election described in section 1400Z-2(c) on the sale or exchange of the qualifying investment. See §1.1400Z2(b)-1(c)(6)(ii)(B) (transferee partnership makes section 1400Z-2(c) election regarding contributed qualifying investment).

(B) Conditions for transferee partnership or merged partnership to make an election described in section 1400Z-2(c). A transferee referred to in paragraph (b)(1)(ii)(A) of this section is eligible to make an election described in section 1400Z-2(c) with respect to a qualifying investment only if the transferee:

(1) Files a statement, at the time and in the manner that the Commissioner of Internal Revenue may prescribe by Internal Revenue Service forms and instructions or by publication in the Internal Revenue Bulletin (see §601.601(d)(ii)(b) of this chapter), providing the name of the transferor, the date of the transfer, and the transferor's holding period in the transferred qualifying investment immediately before the transfer; and

(2) Files form 8997, Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments, with the transferee's timely filed Federal Tax Return.

(iii) Limitation on the 10-year rule. As required by section 1400Z-2(e)(1) (treatment of investments with mixed funds), section 1400Z-2(c) applies only to the portion of an investment in a QOF that is a qualifying investment. For rules governing the application of section 1400Z-2(c) to the portion of an investment in a QOF for which a loss has been claimed under section 165(g) or otherwise, see § 1.1400Z2(b)-1(c)(14).

(iv) Transactions to which section 301(c)(3), section 1059(a)(2), or section 1368(b)(2) or (c)(3) applies. The receipt of amounts treated as gain from the sale or exchange of property under section 301(c)(3), section 1059(a)(2), or section 1368(b)(2) or (c)(3) with respect to qualifying QOF stock in a transaction treated as an inclusion event under §1.1400Z2(b)-1(c) does not prevent the QOF shareholder from making a subsequent election described in section 1400Z-2(c) with respect to that qualifying QOF stock.

(v) Partnership distributions in excess of basis. The occurrence of an inclusion event described in §1.1400Z2(b)-1(c)(6)(iii), which addresses a distribution of property by a QOF partnership to a QOF partner where the distributed property has a fair market value in excess of the QOF partner's basis in its qualifying investment, does not prevent the QOF partner from making a subsequent election described in section 1400Z-2(c) with respect to the QOF partner's qualifying QOF partnership interest.

(2)Special election rules for QOF partnerships and QOF S corporations.

(i) Dispositions of qualifying QOF partnership interests. If a QOF partner's basis in a qualifying QOF partnership interest is adjusted under section 1400Z-2(c) upon the disposition of a qualifying investment, then the basis of the QOF partnership interest is adjusted to an amount equal to the net fair market value of the interest, plus the QOF partner's share of QOF partnership indebtedness under section 752 with respect to that interest, and immediately prior to the sale or exchange, the bases of the assets of the QOF partnership and of any partnership owned directly or indirectly by the QOF partnership solely through one or more partnerships are also adjusted with respect to the disposed-of qualifying investment. For purposes of this paragraph (b)(2)(i), section 7701(g) will apply in determining the value of a qualifying investment in a QOF partnership. The adjustments in this paragraph (b)(2)(i) are calculated in a manner similar to the section 743(b) adjustments that would have been made if the transferor QOF partner had purchased its interest in the QOF partnership for cash equal to the fair market value of the interest immediately prior to the sale or exchange, assuming that valid section 754 elections had been in place with respect to the QOF partnership and any partnerships directly or indirectly owned by the QOF partnership, whether or not an actual section 754 election is in place for any of the partnerships. This paragraph (b)(2)(i) applies without regard to the amount of deferred gain that was included under section 1400Z-2(b)(1) or the timing of that inclusion.

(ii) Sales or exchanges of QOF property by QOF partnerships or QOF S corporations.

(A) Election to exclude gains and losses. If a taxpayer has held a qualifying investment in a QOF partnership or QOF S corporation for at least 10 years, as determined under § 1.1400Z2(b)-1(d), and the QOF partnership or QOF S corporation or any partnership that is owned directly, or indirectly solely through one of more partnerships, by the QOF partnership or QOF S corporation sells or exchanges property, the taxpayer may make an election under this paragraph (b)(2)(ii)(A) to exclude from the taxpayer's income all gains and losses allocable to the qualifying investment that arise from all such sales or exchanges for the QOF partnership's or QOF S corporation's taxable year. In order for the election to be valid, the requirements set forth in paragraph (b)(2)(ii)(B) of this section must be satisfied. For purposes of paragraph (b)(2)(ii) of this section, gains and losses include all gains and losses other than gains or losses from the sale or exchange of any item of inventory, as defined in section 1221(a)(1), in the ordinary course of business.

(B) Deemed distribution and recontribution.

(1) In general. If any partner of a QOF partnership, or shareholder of a QOF S corporation, makes an election under paragraph (b)(2)(ii)(A) of this section, the taxpayer is treated as receiving a distribution of cash as calculated under paragraph (b)(2)(ii)(B)(2) of this section, from the QOF partnership or QOF S corporation at the end of the QOF partnership's or QOF S corporation's taxable year and immediately recontributing the cash to the QOF partnership or QOF S corporation in exchange for a non-qualifying investment in the QOF partnership or QOF S corporation. In determining the post-contribution qualifying investment and non-qualifying investment, the QOF will value each interest based on the underlying values of the QOF's assets determined at the end of its taxable year in accordance with the principles of §1.704-1(b)(2)(iv) (in the case of a QOF partnership) or fair market value (in the case of a QOF S corporation). If the QOF partner or QOF S corporation shareholder is a mixed-funds partner or shareholder prior to the sale or exchange, the deemed distribution will be treated as made proportionately with respect to the partner's or shareholder's qualifying investment and non-qualifying investment in the QOF partnership in accordance with §1400Z2(b)-1(c)(6)(iv)(B), or the QOF S corporation. The distribution and recontribution rule of paragraph (b)(2)(ii)(B) of this section is solely for purposes of determining the taxpayer's interests in the QOF partnership or QOF S corporation that constitute a qualifying investment and a non-qualifying investment, and has no other Federal income tax consequence (for example, the rule does not affect the accumulated adjustments account of an S corporation and cannot be treated as a disproportionate distribution by an S corporation).

(2) Amount of deemed distribution and re-contribution. The amount of cash referred to in paragraph (b)(2)(ii)(B)(1) of this section that is deemed distributed by and recontributed to the QOF partnership or QOF S corporation is equal to-

(i) The partner's or shareholder's share of net proceeds from all sales and exchanges of property described in paragraph (b)(2)(ii)(A) of this section (other than sales of inventory in the ordinary course of business) for the taxable year for which the election under paragraph (b)(2)(ii)(A) is made (calculated without regard to whether any gain or loss is recognized with regard to such property); less

(ii) All actual distributions of cash by the QOF partnership or QOF S corporation with respect to any such sale or exchange that is made within 90 days of the sale or exchange.

(3) Meaning of net proceeds.

(i) QOF partnerships. For purposes of paragraph (b)(2)(ii)(B)(2)(i) of this section, with respect to QOF partnerships, the term ``net proceeds'' means the amount realized from the sale of property described in paragraph (b)(2)(ii)(A) of this section less any indebtedness included in the amount realized that would constitute a qualified liability under §1.707-5(a)(6) if the sold or exchanged property had been contributed to a lower-tier partnership subject to the debt.

(ii) QOF S corporations. For purposes of paragraph (b)(2)(ii)(B)(2)(i) of this section, with respect to QOF S corporations, the term ``net proceeds'' means the amount realized from the sale of property described in paragraph (b)(2)(ii)(A) of this section less any indebtedness included in the amount realized that would constitute a qualified liability under the principles of § 1.707-5(a)(6).

(C) Treatment as exempt income.

(1) General rule. With respect to the taxpayer making an election under paragraph (b)(2)(ii) of this section, the excess of any gains over losses excluded from income under paragraph (b)(2)(ii) of this section is treated as income of the partnership or S corporation that is exempt from tax under the Internal Revenue Code for purposes of section 705(a)(1)(B) or section 1367(a)(1)(A). Section 265 or any similar provisions do not apply to disallow any deductions otherwise allowable under subtitle A for amounts paid or incurred by a taxpayer that are allocable to any gain excluded from income under paragraph (b)(2)(ii) of this section.

(2) Special rule regarding accumulated adjustments account. Solely for purposes of determining whether an adjustment must be made to the accumulated adjustments account of an S corporation, the excess amount described in paragraph (b)(2)(ii)(C)(1) of this section is not treated as tax exempt income.

(D) Time and manner of making the election to exclude gain. An election under paragraph (b)(2)(ii)(A) of this section is made by filing the applicable form with the taxpayer's timely filed income tax return, without extensions, for its taxable year that includes the taxable year end of the QOF partnership or QOF S corporation. A taxpayer must make the election under paragraph (b)(2)(ii)(A) of this section for each taxable year in which it wishes to exclude gains and losses of a QOF partnership or QOF S corporation.

(3)Basis adjustments upon sale or exchange of qualifying QOF stock.

(i) In general. Except as provided in paragraph (b)(3)(ii) of this section, if a QOF shareholder's basis in qualifying QOF stock is adjusted under section 1400Z-2(c), then the basis of the qualifying QOF stock is adjusted to an amount equal to the fair market value of the qualifying QOF stock immediately prior to the sale or exchange. This paragraph (b)(3)(i) applies without regard to the amount of deferred gain that was included under section 1400Z-2(b)(1) or the timing of that inclusion.

(ii) Specific application to transactions to which section 301(c)(3), section 1059(a)(2), or section 1368(b)(2) or (c)(3) applies.

(A) Applicability. This paragraph (b)(3)(ii) applies if a QOF corporation makes a distribution to a QOF shareholder, at least a portion of the distribution would be characterized as gain from a sale or exchange under section 301(c)(3), section 1059(a)(2), or section 1368(b)(2) or (c)(3) with respect to the QOF shareholder's qualifying QOF stock without regard to any basis adjustment under section 1400Z-2(c), and the QOF shareholder elects to adjust the basis of its qualifying QOF stock under section 1400Z-2(c).

(B) Ordering rule. If paragraph (b)(3)(ii) of this section applies with respect to a QOF corporation, the QOF shareholder increases its basis by the lesser of the amount of the distribution characterized as gain from a sale or exchange or the fair market value of the QOF shareholder's qualifying QOF stock before determining the Federal income tax consequences of the distribution.

(c)Extension of availability of the election described in section 1400Z-2(c). The ability to make an election under section 1400Z-2(c) for investments held for at least 10 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.

(d)Examples. The following examples illustrate the principles of paragraphs (a) through (c) of this section.

(1)

Example (1).

(i) Facts. In 2020, taxpayer A invests $100 in QOF S, a QOF S corporation, in exchange for a qualifying investment and defers $100 of gain. At the end of 2028, the qualified opportunity zone designation expires for the population census tract in which QOF S primarily conducts its trade or business. In 2031, A sells all of its QOF S shares, realizes gain, and makes an election to increase the qualifying basis in its QOF S shares to fair market value. But for the expiration of the designated zones in section 1400Z-1(f), QOF S and A's conduct is consistent with continued eligibility to make the election under section 1400Z-2(c).

(ii) Analysis. Under paragraph (c) of this section, although the designation expired on December 31, 2028, the expiration of the zone's designation does not, without more, invalidate A's ability to make an election under section 1400Z-2(c). Accordingly, pursuant to that election, A's basis in the QOF stock is increased to its fair market value and A recognizes no gain or loss on the sale.

(2)

Example (2).

(i) Facts. In 2019, taxpayer A realizes $100 of eligible gain and contributes $100 to a QOF partnership, X, in exchange for a qualifying QOF partnership interest in X, and taxpayer B contributes $100 of eligible gain to another QOF partnership, Y, in exchange for a qualifying QOF partnership interest in Y. In 2021, in transactions governed by section 721(a), A contributes her qualifying QOF partnership interest in X, and B contributes her qualifying QOF partnership interest in Y, to a newly formed partnership, UTP. In 2024, C receives a profits interest in UTP for services that she will provide to UTP. In 2031, X sells a non-inventory asset and allocates X's distributive share of the gain to UTP. No distributions are ever made from X, Y, or UTP.

(ii) Analysis. On December 31, 2026, UTP recognizes $170 of remaining deferred gain relating to the QOF interests. Of that gain, A is allocated the $85 of gain relating to the $100 of eligible gain that she invested in X, and B is allocated the $85 of gain relating to the $100 of eligible gain that she invested in Y. C recognizes no gain at this time. In 2031, because UTP's holding period in X includes A's holding period in X, UTP has a holding period in X that exceeds 10 years, and may make an election under §1.1400Z2(c)-1(b)(2)(ii)(A) to exclude the gain from X's asset sale. Even though A was the original investor in X, she may not make the election. If UTP makes the election, UTP will exclude its distributive share of gain from the sale of the X asset.

(3)

Example (3).

(i) Facts. In 2019, taxpayer B invests $100 in P, a QOF partnership, in exchange for a qualifying investment and properly makes an election under section 1400Z-2(a) to defer $100 of eligible gain. B's interest in the partnership is 50 percent. In 2030, when B's interest in P has a value of $130 and a basis of $100, B sells the interest, recognizing $30 of gain, $15 of which is attributable to inventory assets of P. B makes an election under section 1400Z-2(c) with respect to the sale.

(ii) Analysis. Because B's election under section 1400Z-2(c) is in effect with respect to the sale, the bases of B's interest in P and of P's assets with respect to the interest sold are adjusted to fair market value immediately before B's sale under paragraph (b)(2)(i) of this section, and B recognizes no gain or loss on the sale.

(4)

Example (4).

(i) Facts. The facts are the same as in paragraph (d)(3) of this section (Example 3), except that P sells qualified opportunity zone property that is not inventory sold in the ordinary course of business and distributes all of the proceeds from the sale to partners within 90 days of the sale (the qualified opportunity zone property was the only property sold by P in the taxable year). The sold property has a value of $60 and a basis of $40. P recognizes $20 of gain, $10 of which is allocable to B, and B makes an election under paragraph (b)(2)(ii)(A) of this section for the year in which B's allocable share of the partnership's recognized gain would be included in B's gross income.

(ii) Analysis. Because B's election under paragraph (b)(2)(ii)(A) of this section is in effect, B will exclude its entire $10 allocable share of the partnership's $20 of recognized gain. Because $10 of the sale proceeds were actually distributed to B within 90 days of the sale, P is not treated as making a deemed distribution and receiving a recontribution under paragraph (b)(2)(ii)(B) of this section with respect to B.

(5)

Example (5).

(i) Facts. In 2019, taxpayer C invests $100 in Q, a QOF partnership, in exchange for a qualifying investment and properly makes an election under section 1400Z-2(a) to defer $100 of eligible gain. C's interest in Q is 50%. Q's taxable year ends on December 31. In 2025, Q purchases three qualified opportunity zone properties, X, Y, and Z. On January 22, 2031, Q sells property X for $200, recognizing $140 of gain. On July 31, 2031, Q sells property Y for $80, recognizing $20 of loss. Q makes no distributions to its partners in 2031, has no indebtedness, and has no other gain or loss other than from the sales of properties X and Y. Property Z has a value of $280 at all times throughout 2031. C's share of Q's gain and loss is $70 and $10, respectively, for a net gain of $60, and C makes an election under paragraph (b)(2)(ii)(A) of this section to exclude the gains and losses from its income.

(ii) Analysis. Because C has made an election under paragraph (b)(2)(ii)(A) of this section, under paragraph (b)(2)(ii)(B) of this section, C is treated as receiving a cash distribution of $140 from Q, C's share of the net proceeds from the sales of properties X and Y, on December 31, 2031, and immediately recontributing $140 to Q in exchange for a non-qualifying investment in Q. Beginning on January 1, 2032, 50 percent of A's interest in Q is a qualifying investment, and 50 percent of A's investment in Q is a non-qualifying investment. This amount is calculated as a fraction, the numerator of which is $140, the amount deemed distributed and recontributed, and the denominator of which is $280, the value of C's interest prior to the deemed distribution.

(6)

Example (6).

(i) Facts. The facts are the same as in paragraph (d)(5) of this section (Example 5), except that Q distributes all of the proceeds from the sale of property X to its partners on March 30, 2031. Q does not make any distribution of proceeds from the sale of property Y.

(ii) Analysis. Under paragraph (b)(2)(iii)(B)(2)(ii) of this section, the actual distribution of cash to C on March 30, 2031, reduces the amount of the deemed distribution and recontribution with respect to C on December 31, 2031. Accordingly, the amount of C's deemed distribution and recontribution is $40, which increases C's non-qualifying investment to 22 percent. This amount is calculated as a fraction, the numerator of which is $40, the amount deemed distributed and recontributed, and the denominator of which is $180, the value of C's interest.

(7)

Example (7). Section 301(c)(3) gain.

(i) Facts. In 2020, taxpayer X makes an investment in Q, a QOF corporation, in exchange for a qualifying investment. In 2031, when X's qualifying Q stock is worth $1000x, Q makes a distribution to X with respect to X's qualifying QOF stock, $500x of which is treated as gain from a sale or exchange under section 301(c)(3). In 2032, X disposes of all of its qualifying QOF stock in Q.

(ii) Analysis.

(A) Section 301(c)(3) distribution. X is eligible to make an election described in section 1400Z-2(c) in 2031 with respect to its $500x gain. Under paragraph (b)(3)(ii) of this section, the basis adjustment is $500x, the lesser of $500x, the amount of the distribution treated as gain from the sale or exchange of property, and $1000x, the fair market value of the qualifying QOF stock before the distribution. As a result of the election, X increases its basis in its qualifying QOF stock in Q by $500x immediately before the distribution; consequently, the $500x is treated as a return of basis under section 301(c)(2).

(B) Disposition of qualifying QOF stock. X is eligible to make an election described in section 1400Z-2(c) in 2032 with respect to all of its qualifying QOF stock in Q, notwithstanding X's receipt of a section 301(c)(3) distribution in 2031. See paragraph (b)(1)(iv) of this section.

(e)Capital gain dividends paid by a QOF RIC or QOF REIT that some shareholders may be able to elect to receive tax free under section 1400Z-2(c).

(1)Eligibility. For purposes of paragraph (b) of this section, if a shareholder of a QOF RIC or QOF REIT receives a capital gain dividend identified with a date, as defined in paragraph (e)(2) of this section, then, to the extent that the shareholder's shares in the QOF RIC or QOF REIT paying the capital gain dividend are a qualifying investment in the QOF RIC or QOF REIT.

(i) The shareholder may treat the capital gain dividend, or part thereof, as gain from the sale or exchange of a qualifying investment on the date that the QOF RIC or QOF REIT identified with the dividend; and

(ii) If, on the date identified, the shareholder had held that qualifying investment in the QOF RIC or QOF REIT for at least 10 years, then the shareholder may exclude that capital gain dividend, or part thereof, from its taxable income for the taxable year.

(2)Definition of capital gain dividend identified with a date. A capital gain dividend identified with a date means an amount of a capital gain dividend, as defined in section 852(b)(3)(C) or 857(b)(3)(B), or part thereof, and a date that the QOF RIC reports or QOF REIT designates in a notice provided to the shareholder not later than one week after the QOF RIC reports or QOF REIT designates the capital gain dividend pursuant to section 852(b)(3)(C) or 857(b)(3)(B). The notice must be mailed to the shareholder unless the shareholder has provided the QOF RIC or QOF REIT with an email address to be used for this purpose. In the manner and at the time determined by the Commissioner, the QOF RIC or QOF REIT must provide the Commissioner all data that the Commissioner specifies with respect to the amounts of capital gain dividends and the dates reported or designated by the QOF RIC or QOF REIT for each shareholder.

(3)General limitations on the amounts of capital gain with which a date may be identified.

(i) No identification in the absence of any capital gains with respect to qualified opportunity zone property. If, during its taxable year, the QOF RIC or QOF REIT did not recognize long-term capital gain on any sale or exchange of qualified opportunity zone property, then no date may be identified with any capital gain dividends, or parts thereof, with respect to that year.

(ii) Proportionality. Reportings and designations of capital gain dividends identified with a date must be proportional for all capital gain dividends paid with respect to the taxable year. See section 857(g)(2). Greater than de minimis violation of proportionality invalidates all of the purported identifications for a taxable year.

(iii) Undistributed capital gains. If section 852(b)(3)(D)(i) or 857(b)(3)(C)(i) requires a shareholder of a QOF RIC or QOF REIT to include a reported or designated amount in the shareholder's long-term capital gain for a taxable year, then inclusion of this amount in this manner is treated as receipt of a capital gain for purposes of this paragraph (e) and may be identified with a date.

(iv) Gross gains. The amount determined under paragraph (e)(4) of this section is determined without regard to any losses that may have been recognized on other sales or exchanges of qualified opportunity zone property. The losses do, however, limit the total amount of capital gain dividends that may be reported or designated under section 852(b)(3) or section 857(b)(3).

(4)Determination of the amount of capital gain with which a date may be identified. A QOF RIC or QOF REIT may choose to identify the date for an amount of capital gain in one of the following manners:

(i) Simplified determination. If, during its taxable year, the QOF RIC or QOF REIT recognizes long-term capital gain on one or more sales or exchanges of qualified opportunity zone property, then the QOF RIC or QOF REIT may identify the first day of that taxable year as the date identified with each reported or designated amount with respect to the capital gain dividends for that taxable year. A reported or designated identification is invalid in its entirety if the amount of gains that the QOF RIC or QOF REIT identifies with that date exceeds the aggregate long-term capital gains recognized on those sales or exchanges for that taxable year.

(ii) Sale date determination.

(A) In general. If, during its taxable year, the QOF RIC or QOF REIT recognizes long-term capital gain on one or more sales or exchanges of qualified opportunity zone property, then the QOF RIC or QOF REIT may identify capital gain dividends, or a part thereof, with the latest date on which there was such a recognition. The amount of capital gain dividends so identified must not exceed the aggregate long-term capital gains recognized on that date from sales or exchanges of qualified opportunity zone property. A reported or designated identification is invalid in its entirety if the amount of gains that the QOF RIC or QOF REIT identifies with that date violates the preceding sentence.

(B) Iterative application. The process described in paragraph (e)(4)(ii)(A) of this section is applied iteratively to increasingly earlier transaction dates (from latest to earliest) until all capital gain dividends are identified with dates or there are no earlier dates in the taxable year on which the QOF RIC or QOF REIT recognized long-term capital gains with respect to a sale or exchange of qualified opportunity zone property, whichever comes first.

(f)Applicability dates. The provisions of this section are applicable for taxable years beginning after March 13, 2020.