differences among the leading alternatives now being discussed are mainly about the treatment of residual profits. Those differences are:

1. Devereux et al. proposal — all residual profits are allocated by gross income.
2. Avi-Yonah et al. — all residual profits are allocated by sales.
3. Marketing intangible proposal — residual profits from marketing intangibles are allocated by some apportionment factor (almost certainly sales). The location of all other profits is determined under arm's-length methods.
4. Income inclusion/minimum tax proposal targeted at profit shifting — any profits of foreign subsidiary determined under the arm's-length method to be in excess of routine profit and subject to low tax are subject to tax in the multinational's home country.

Using this characterization of the major proposals, several points are easy to make. The critical issue in all is the treatment of residual profits. Proposals 1 and 2 have a great deal in common, and they would entail the largest change from current law. Proposal 3 is less of a change from current law than proposals 1 and 2 but is undoubtedly much more complex because of the need to separate marketing from other intangibles. All three of those pillar 1-type proposals are far more sweeping than the minimum tax in proposal 4, both in terms of concept and in terms of amounts of revenue up for grabs.

The practitioner community would prefer a conservative approach. From its perspective, if there must be change, let it be along the lines of proposal 4. But the advice embodied in practitioner comments to the OECD may not prevail if budgetary and political pressures force nations to adopt unilateral measures designed to protect their tax base and their domestic businesses. ■

NEWS ANALYSIS

Just How Taxpayer-Friendly Are the New O-Zone Rules?

by Marie Sapirie

Investors and managers of qualified Opportunity Zone funds can breathe a little easier following the release of the second set of proposed regulations, but despite Treasury's suggestion that there might not be a third set coming, questions remain. Overall, the new rules succeed at working toward the legislative goals for the program and encouraging more investors to enter the regime.

The proposed regulations (REG-120186-18) provide more flexibility in structuring investments in qualified opportunity funds, but they aren't a blank check. "If you have an asset sale, there are still hurdles," said Jessica Millett of Duval & Stachenfeld LLP. Capital can be commingled in a single vehicle and a Schedule K-1 issued from a single fund, subject to a few uncertainties and potential inefficiencies. The administrative consequences of establishing only single asset funds were creating headaches, but the new rules have mitigated those worries.

The proposed regulations include an extension of the working capital safe harbor, expanded options for leasing property, and a generous original use test. The rules help clarify the effects of distributions of refinancing proceeds. The proposed regulations explain that if a QOF is a partnership, there's a basis credit for the allocable share of debt under section 752. As long as the distribution isn't a taxable return of capital, distributions of financing proceeds or allocations of depreciation are allowed, which is a helpful clarification, Millett said.

> ***The proposed regulations provide more flexibility in structuring investments in QOFs, but they aren't a blank check.***

But the proposed rules aren't as clear on several points that practitioners would have liked to see addressed in the previously promised third tranche of rules. Although the new rules offer more flexibility for taxpayers "when analyzing

For more *Tax Notes* content, please visit www.taxnotes.com.

© 2019 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

© 2019 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

how transactions would work, you end up with a bit of ambiguity on some issues," said Jonathan Talansky of King & Spalding LLP. He said that if the government forgoes a third set of proposed rules, it will hopefully issue other types of guidance to address outstanding issues, perhaps in rulings. Whatever is unaddressed will require reasoned judgment from tax advisers and their clients.

Two aspects of the proposed regulations were less welcome from a taxpayer perspective, Millett said. First, the proposed rules require taxpayers with gain from the sale of an asset under section 1231 that has been used in a trade or business to net their gains and losses under section 1231 to determine if there's net positive gain for a tax year, and only that gain is eligible for purposes of the Opportunity Zone benefits. Holders of commercial real estate therefore will be unable to invest their gain until December 31, because that's when they'll know whether they have net positive gain under section 1231. Because that rule differs substantially from the requirement to reinvest gains within 180 days of the sale of an asset, it will surprise taxpayers, Millett said.

> ***There are some surprising results in the proposed rules and others that might require more smoothing out in the final version, the chief example being the continuing, somewhat surprising bias toward a single asset fund structure.***

Second, the proposed rules stymie getting QOF tax benefits on a carried interest under section 1400Z-2, because a partnership interest granted in exchange for services isn't an eligible interest entitled to the special benefits of the QOF regime, even if all the partnership's investments are qualifying investments. That clarification was widely expected, Millett said.

There are some surprising results in the proposed rules and others that might require more smoothing out in the final version, the chief example being the continuing, somewhat surprising bias toward a single asset fund structure. For instance, the rules appear to give a better result on ordinary depreciation recapture if investors sell an interest in a QOF rather than the fund selling its assets, Talansky said. One example in the regulations provides that if the interest in the fund is sold, it wipes out all the gain that would otherwise be recharacterized as the recaptured amount, but if the sale is at the lower level, those rules might not apply, and the recaptured amount would be treated as ordinary income.

Talansky noted that because QOFs are allowed to hold some nonqualifying assets under the 90 percent test, an equity sale has a better result than a sale of the fund's entire portfolio because of the step-up in basis to fair market value upon the sale of the interest. It's also notable that the portion of the rules that seems to allow funds to sell assets and for investors to exclude their share of Schedule K-1 capital gain isn't immediately effective, and investors cannot rely on it like they can with the other parts of the proposed regulations.

Investments Held for at Least 10 Years

In L. Frank Baum's *The Wizard of Oz*, the titular "wizard" sails into the Land of Oz in a hot air balloon, and near the end of the action sails right back out, a feat that many investors would like to accomplish in Opportunity Zones. The entity sale requirement in the statute was making investors doubt how easy that might be in reality. The proposed rules aren't exactly a pair of magic silver slippers in that they don't allow taxpayers to structure and exit their investments however they choose, but they offer more flexibility. Coupled with the other rules in the proposed regulations, they should help bring more investors into QOFs and keep QOFs from accidentally landing in the deadly desert of penalties.

Prop. reg. section 1.1400Z2(c)-1 was supposed to be a big win for investors because it allows a partnership to sell its underlying assets and the investors to exclude the gain on the sale without selling their interests, but questions linger. Practitioners initially read that section to mean that capital gain could be excluded as long as the investor holds the QOF interest at the 10-year mark, but as drafted, the rule applies only when a QOF disposes of property.

Because most of the structures are two-tiered, with a QOF owning a qualified Opportunity Zone business (QOZB), the QOF often won't own the

For more *Tax Notes* content, please visit www.taxnotes.com.

© 2019 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

underlying property directly. "Did [Treasury] really mean for that rule to apply to the situation where the joint venture sells property, or only to situations where the QOF sells property?" Millett asked. She said that in light of the non-reliance qualification, QOFs would want to ensure that their structures are flexible enough to allow an entity sale at exit.

Talansky said that some of those persistent complexities are unfortunate since the government clearly wanted to address the multi-asset fund issue. Although it seems unlikely that Treasury will curtail the proposed rules because the intention is evidently to accommodate taxpayers, funds are continuing to debate whether they want to change their strategies, Talansky said. "When you evaluate the rules in their entirety, where you get to is very few people are saying we're going to shift our fund structure and have a single fund that holds a portfolio, which is ironic because that's what the government seemed to want to promote," he said.

> ***Although it seems unlikely that Treasury will curtail the proposed rules because the intention is evidently to accommodate taxpayers, funds are continuing to debate whether they want to change their strategies, Talansky said.***

In addition to the question whether the asset sale rules might be expanded, Treasury left taxpayers hanging on the issue of exit planning. In the proposed effective date section, Treasury explained that "pre-finalization reliance does not apply to the rules of proposed section 1.1400Z2(c)-1 set forth in this notice of proposed rulemaking as these rules do not apply until January 1, 2028." The rationale for excluding the asset sale rules is probably that there won't be anyone relying on them in filing tax returns for 10 years. But investors of course want to know what the rules will be in 10 years when they plan to exit their investments. "In a sense, the 10-year provision is one of the most helpful and at the same time one of the most frustrating, because you can't cross it off the list" because of the uncertainties and your inability to rely on it, Millett said.

A Boost for Operating Businesses

The ultimate success and longevity of the Opportunity Zone regime largely rides on whether operating businesses move into the zones and establish new employment opportunities for current local residents. But until the latest round of proposed regs, the rules for operating businesses were still amorphous. By giving QOZBs flexibility in how they meet the 50 percent gross income test — through hours of service, amount of compensation, tangible property and management or operational functions, or the catchall facts and circumstances test — the proposed rules are designed to promote operating businesses.

> ***'Making this program thrive and accomplishing the policy goals of bringing in more economic activity will largely happen through the operating business side of it,' Millett said.***

Start-up businesses and predominantly digital businesses were clearly a concern, as an example in the preamble illustrates. The safe harbor for tangible property and management functions might end up causing some enforcement headaches down the road, because confirming that management or operational functions done in the zone are necessary to generate 50 percent of the gross income could be difficult. Also, the example in the preamble suggests that simply storing tangible property used in the business in the zone is sufficient, which isn't entirely consistent with the idea of boosting activity in the zones. The point was to be helpful, however, and it's possible that this safe harbor will eventually be more of a gloss on the facts and circumstances option.

Millett said the safe harbors for operating businesses look good, but that time will tell how easy they are to apply to actual businesses. "Making this program thrive and accomplishing the policy goals of bringing in more economic activity will largely happen through the operating business side of it," she said. At the same time that Treasury released the proposed regulations, it issued a request for information about information collection "to measure the

For more Tax Notes content, please visit www.taxnotes.com.

effectiveness of the policy in achieving its stated goals and ensure that this investment opportunity remains an attractive option for investors to use." Treasury indicated that it planned to revise Form 8996, "Qualified Opportunity Fund," to ask for information on the amount invested by QOFs and QOZBs. The post-implementation data, which Treasury indicated will have a two-year lag, will be instrumental in the eventual evaluation of the Opportunity Zone incentives. (Prior analysis: *Tax Notes*, Apr. 1, 2019, p. 19.) ■

TAX HISTORY

10 Questions About Presidents And Their Tax Returns

by Joseph J. Thorndike

For over 20 years, the Tax History Project has been collecting and archiving tax returns filed by American presidents, vice presidents, and candidates for both offices. These returns, publicly available on the *Tax Notes* website, have prompted several recurring questions over the years. Here are 10 of the most common.

1. Are presidents required to release their tax returns?

Presidents aren't required by law to release their tax returns.

Nevertheless, between 1974 and 2012, every president but Gerald Ford has made a voluntary release of the tax returns they filed while in office. Ford released no complete returns, but released 10 years of summary data including gross income, taxable income, major deductions, and taxes paid. (Prior analysis: *Tax Notes*, Feb. 11, 2019, p. 612.)

This tradition of voluntary tax return disclosure ended in 2017, when President Trump declined to release any personal tax information. Trump has offered various reasons for keeping his returns private, but he has frequently insisted that he won't make a release while his returns are being audited by the IRS.

2. Are all presidents audited by the IRS?

Since 1977 the Internal Revenue Manual has required that every tax return filed by a sitting president or vice president be subject to an audit. According to IRS officials at the time, the new policy was established "in the interest of sound administration" and in light of "everything that has happened in the past." (Prior analysis: *Tax Notes*, Feb. 25, 2019, p. 867.)

While Trump may be unwilling to release tax returns currently under audit, that's a prudential decision, not a legal one. There's no legal bar to releasing returns that are under examination. In fact, every president from Jimmy Carter through Barack Obama released returns that were "under audit," since those returns — generally released

© 2019 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes* content, please visit www.taxnotes.com.