WINSTON & STRAWN LLP

BLOG

IRS Notices, Additional Actions Expected Following TIGTA Report Assessing Opportunity Zone Compliance

APRIL 7, 2022

In response to TIGTA's [1] final report, issued on February 7, 2022, the IRS has agreed to issue notices to potentially noncompliant opportunity zone (OZ) funds and investors. TIGTA's review noted that 341 funds and 5,141 investors warranted closer examination and the issuance of IRS enforcement notices to ensure compliance with applicable reporting and qualification requirements.

Opportunity Zones

Section 13823 of the Tax Cuts and Jobs Act [2] (TCJA), enacted in 2017, introduced the OZ provisions as a measure to spur economic development and job creation in distressed communities throughout the United States and U.S. territories. As an incentive to invest in qualified OZs, OZs provide investors the opportunity to receive tax benefits that include deferral of eligible gains, a step-up in OZ investment basis for deferred gains invested, and certain exclusions from gross income of gains (provided certain holding period requirements are met). Through this process, the Secretary of the Treasury has approved and designated 8,764 census tracts as qualified opportunity zones—that have attracted investment—since the provision's enactment.

The OZ provisions require that a qualified OZ fund hold at least 90% of its assets in qualifying OZ property and provide that any investments in other OZ funds are not incorporated into the computation of the 90% threshold. A fund that fails to meet the 90% test is typically subject to a penalty for each month in which it fails to meet the requirement in an amount equal to the excess of (1) the amount equal to 90% of its aggregate assets, over (2) the aggregate amount of qualified OZ property held by the fund, multiplied by (3) the underpayment rate for the month defined in I.R.C. § 6621(a)(2). [3]

TIGTA's Final Report

TIGTA's final report presented its review of the IRS's implementation of OZ provisions and the processes taken by the IRS to ensure that OZ funds and associated investors were complying with the annual reporting and qualification requirements. The report culminated in eight recommendations to the IRS to ensure and improve investor compliance. Of those eight recommendations, the IRS agreed to six, including TIGTA's recommendation on issuing notices to taxpayers to evaluate compliance.

With regard to fund reporting, TIGTA's recommendation included a compliance initiative project to address 699 funds with invalid information and 341 funds with reported investments in other funds (or themselves). In examining 5,319 e-filed Forms 8996 for tax year 2019, TIGTA identified 341 funds (6.4% of total reviewed) that reported making investments in other funds and 108 funds (2.3% of total reviewed) making investments in themselves. The IRS expressed agreement with TIGTA's recommendation and noted its intent to develop and issue notices to the funds identified by TIGTA.

With regard to investor reporting, TIGTA's review found that the IRS had not established appropriate processes and procedures to identify inaccuracies and inconsistencies in the information reported by investors. TIGTA's review noted that Form 8996 does not require funds to provide tax identification numbers (TINs) of investors disposing of their interests in the fund, thereby presenting the opportunity for inaccurate or incomplete reporting of gains. The IRS also adopted this recommendation, and in response the IRS updated its tax-year 2021 instructions to include TINs as part of the Form 8996[4] where an investor disposed of its interest in the fund. Furthermore, the IRS agreed to develop and issue notices to 5,141 investors identified by TIGTA as containing incomplete or inaccurate information on their Form 8997[5] filings. TIGTA's report found other notable deficiencies in the IRS's compliance, including Forms 8996 not being filed in tax year 2019, as required, and IRS processes not transcribing key data fields from paper-filed Forms 8996 and 8997.

Key portions of TIGTA's report discussing compliance with reporting requirements are heavily redacted in the report released to the public. As a result, the precise contours of the overall compliance initiative are not entirely clear, and the approach the IRS initiative will take remains to be seen. Nonetheless, the unredacted portions of the report provide valuable insight into likely areas of IRS scrutiny in the near future.

****

Winston & Strawn will continue to monitor any further developments. For further information, or if you have received a notice from the IRS, please contact any of the authors listed below or your Winston relationship attorney.

---

[1] Treasury Inspector General for Tax Administration (TIGTA) was established in January 1999, in accordance with the Internal Revenue Service (IRS or Service) Restructuring and Reform Act of 1998, to provide independent oversight of IRS activities. Since that time, TIGTA has conducted audits and investigations to improve IRS operations and issued semiannual reports to highlight the findings of its audits and investigations.

[2] Pub. L. No. 115-97, 131 Stat. 2054 (2017).

[3] Notably, as a relief measure provided in response to the COVID-19 pandemic, relief was provided for tax periods in which any semiannual testing date was on or between April 1, 2020 and June 30, 2021.

[4] Form 8996, *Qualified Opportunity Fund*, is used by corporations or partnerships to self-certify their election as a qualified OZ fund and to provide an accounting of the fund's investments for the tax year.

[5] Form 8997, *Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments*, is used by investors to report their investments into a QOF and is typically attached to an investor's income tax return to provide for an accounting of the taxpayer's investments in QOFs for the tax year.

4 Min Read

Authors

Karl Kurzatkowski

James N. Mastracchio

Susan Elizabeth Seabrook

Zachary C. Weit

Related Locations

Washington, DC

Related Topics

IRS

TIGTA

Tax

Compliance

Opportunity Zone

Related Capabilities

Tax

Tax Controversy & Criminal Tax

Related Regions

North America

Related Professionals

Karl Kurzatkowski

James N. Mastracchio

Susan Elizabeth Seabrook

Zachary C. Weit

This entry has been created for information and planning purposes. It is not intended to be, nor should it be substituted for, legal advice, which turns on specific facts.