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New Qualified Opportunity Fund Reporting Requirements

A&S Opportunity Zone Practice Group

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It is pretty uncommon (or maybe entirely unheard of before now?) for the release of a new tax form by the IRS to be met with excitement, but the Land of OZ was aflutter last week when new IRS Form 8996 ("Form 8996") was released in draft form.[1] On its face, the new form expands the technical reporting requirements that a Qualified Opportunity Fund ("QOF") has to comply with. More importantly though, new Form 8996 is the first step towards the data collection and impact measurements that many believe will be critical to the success of the Opportunity Zone program.

1. What is Form 8996?

Every QOF is required to include Form 8996 with its tax return annually. A QOF actually elects its status as a QOF by filing Form 8996 in its first taxable year, and Form 8996 is used by a QOF every year to report its compliance with the 90% asset test. If a QOF does not meet its 90% asset test in a particular year, Form 8996 also includes the calculation of the penalty for noncompliance.

The questions included on the old Form 8996 have generally carried over without change, so the QOF election remains, as does the basic measurement of compliance with the 90% test and the penalty calculation.

2. What is new?

There are a few important changes reflected on the new Form 8996.

First though, a quick refresher on QOF structures, which is important to understand for some of the changes to Form 8996. As a reminder, a QOF can own property directly in the single-tier structure, in which case at least 90% of the QOF's assets have to be Qualified Opportunity Zone Business Property ("QOZBP").[2]

Most QOFs use the two-tier structure, where the QOF owns equity in a subsidiary partnership or corporation that qualifies as a Qualified Opportunity Zone Business ("QOZB"). The QOZB then owns QOZBP in compliance with its own set of tests. Since equity in a QOZB is a good asset in the hands of a QOF, the QOF can meet its 90% test by owning an interest in a QOZB.

Now, on to the changes:

[1] The new version of IRS Form 8996 is still in draft form, so it cannot be used yet by a QOF. A link to the new draft form is here.

[2] For a further explanation about QOZBP and the associated requirements, see our Opportunity Zone roadmaps.

- Census tract data – Form 8996 requires a QOF to report every census tract where its QOZBP (held directly or through a QOZB) is located. This is a big step towards replacing some of the reporting requirements that were stripped out of the original Opportunity Zone bill during the tax reform process.

- Owned property vs leased property – QOFs now have to break down the value of their QOZBP (again, whether held directly or through a QOZB) between owned property and leased property. QOFs also have to specify which method is being used to value the property (cost basis or financial statement values).

- QOZB information – Reflecting the reality that most QOFs are using the two-tier structure, the IRS is now asking QOFs to report the tax ID number (EIN) of any QOZBs that the QOF is investing in, and the value of the QOF's investment in each QOZB.

- Dispositions by investors – New Form 8996 requires a QOF to report any dispositions (partial or full) of QOF equity by an investor during the year. Although the accompanying instructions have not yet been released for the new Form 8996, presumably the disposition concept here will track the definition of inclusion events in the Treasury Regulations.

3. What is still missing?

As indicated above, the original version of the Opportunity Zone bill contained reporting requirements, which were stripped out of the legislation during tax reform. Those requirements included the value of assets held by QOFs, the types of assets held by QOFs, and the census tracts that received QOF investments. The original bill also required Treasury to report to Congress "an assessment of the impacts and outcomes of the investments in those areas on economic indicators including job creation, poverty reduction, and new business starts, and other metrics…"

Senator Booker introduced a bill in May 2019 to reinstate and expand the missing requirements, but no new legislation has been passed.

Treasury published a notice in April 2019 (in conjunction with its release of the second set of proposed Treasury Regulations on the Opportunity Zone program) asking for comments on the type of data that should be collected with respect to the Opportunity Zone program. It remains to be seen whether Treasury will implement additional reporting requirements in connection with the release of the final Treasury Regulations (expected before the end of the year, maybe) or whether we will have to wait for

Congress to vote on new reporting requirements (which most certainly will not happen before the end of the year).

4. Why is this important?

There has been some negative publicity around Opportunity Zones lately, focusing mainly on the investor level tax benefits. However, the Opportunity Zone program has two distinct policy goals: freeing up capital that has been locked up by investors in capital assets (the investor level tax benefit) and revitalizing low-income communities (the investment requirements).

Many of the skeptics of the Opportunity Zone program are targeting the investor level tax benefit, and it has been difficult for the proponents of the program to illustrate the community level impact because of the lack of information on which communities are benefiting and by how much. The census tract data now required on new Form 8996 is a good start, but additional investment level data and impact will go a long way in helping to measure whether the Opportunity Zone program is accomplishing its intended goals.

The A&S Opportunity Zone Practice Group brings together a 50-person team, including lawyers, paralegals, and our business professionals providing a unique value add for clients. The OZ team is led by:

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