DESCRIPTION OF H.R. 3937, THE "SMALL BUSINESS JOBS ACT"

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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 3937, the "Small Business Jobs Act." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 3937, the "Small Business Jobs Act"* (JCX-26-23), June 9, 2023. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references in the document are to the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise stated.

A. Increase in Threshold for Requiring Information Reporting with Respect to Certain Payees

Present Law

Information reporting requirements

Present law requires persons to file an information return concerning certain transactions with other persons.[2] The person filing an information return (the "payor") is also required to provide the person for whom the information return is being filed (the "payee") with a written statement showing the information that was reported to the Internal Revenue Service ("IRS"), which generally includes aggregate payments made, and the contact information for the payor.[3] These returns are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete.

For example, every person engaged in a trade or business who makes certain payments aggregating $600 or more in any taxable year to a single payee in the course of such trade or business must report those payments to the IRS.[4] This requirement applies to fixed or determinable payments of income as well as nonemployee compensation, generally reported on either Form 1099-MISC, *Miscellaneous Information*, or Form 1099-NEC, *Nonemployee Compensation*. In addition, any service recipient engaged in a trade or business and paying for services is required to make a return according to regulations when the aggregate of payments is $600 or more.[5] Government entities are specifically required to make an information return, reporting payments to corporations as well as individuals.[6]

However, these provisions discussed above do not cover payments for goods or certain enumerated types of payments that are subject to other specific reporting requirements, such as provisions covering dividends, interest, and royalties.[7] Treasury regulations generally provide further exceptions from the reporting of payments to corporations, exempt organizations, governmental entities, international organizations, and retirement plans.[8]

A person who is required to file information returns but who fails to do so by the due date for the returns, includes on the returns incorrect information, or files incomplete returns

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[2] Secs. 6041 through 6050Y.

[3] See, *e.g.*, sec. 6041(d).

[4] Sec. 6041.

[5] Sec. 6041A.

[6] Sec. 6041A(d)(3)(A).

[7] Section 6041(a) generally excepts from its scope most interest, royalties, and dividends, which are instead covered by sections 6049, 6050N, and 6042, respectively.

[8] Treas. Reg. sec. 1.6041-3. Certain for-profit health care provider corporations are not covered by this general exception, including those organizations providing billing services for such companies.

generally is subject to a penalty of $250 for each return with respect to which such a failure occurs, up to a maximum of $3,000,000 in any calendar year, adjusted for inflation.[9] Similar penalties apply to failures to furnish correct written statements to recipients of payments for which information reporting is required.[10] The failure to file and failure to furnish penalties are reduced for small businesses[11] and increased for failures due to intentional disregard.[12]

Backup withholding

Generally, a payor is not required to withhold taxes from payments to the payee. However, a payor may be required to deduct and withhold income tax on certain "reportable payments" at a rate equal to 24 percent[13] if: (1) the payee fails to furnish his or her taxpayer identification number ("TIN") to the payor; (2) the IRS notifies the payor that the payee's TIN is incorrect; (3) a notified payee underreporting of reportable payments has occurred; or (4) a payee certification failure with respect to reportable payments has occurred.[14] The requirement to deduct and withhold in the case of a notified payee underreporting or a payee certification failure applies solely to reportable interest or dividend payments. These deduction and withholding requirements[15] are referred to as backup withholding.

Reportable payments are defined as any reportable interest or dividend payment and any other reportable payment.[16] A reportable interest or dividend payment means any payment of a kind, and to a payee, required to be shown on an information return required under any of the following sections: (i) 6049(a), relating to payments of interest, (ii) 6042(a), relating to payments of dividends, or (iii) 6044, relating to payments of patronage dividends, but only to the

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[9] Sec. 6721. These amounts are adjusted annually for inflation. For information returns required to be filed in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per calendar year. For information returns required to be filed in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per calendar year. The penalties are reduced if the failure is corrected within a specified amount of time. Sec. 6721(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a).

[10] Sec. 6722. These amounts are also adjusted annually for inflation. For information statements required to be filed in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per calendar year. For information statements required to be filed in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per calendar year. The penalties are reduced if the failure is corrected within a specified amount of time. Sec. 6722(b). The penalties are waived if a person establishes that any failure was due to reasonable cause and not willful neglect. Sec. 6724(a).

[11] Secs. 6721(d) and 6722(d).

[12] Secs. 6721(e) and 6722(e).

[13] Sec. 3406(a)(1)(D). The backup withholding rate is the fourth lowest rate of tax applicable under section 1(c). In 2023, this rate is 24 percent.

[14] Sec. 3406(a)(1).

[15] Sec. 3406.

[16] Sec. 3406(b).

extent such payment is in money and only if 50 percent or more of such payment is in money. Any other reportable payment means any payment of a kind, and to a payee, required to be shown on a return required under any of the following sections: (i) 6041, relating to certain information at source, (ii) 6041A(a), relating to payments of remuneration for services, (iii) 6045, relating to returns of brokers, (iv) 6050A, relating to reporting requirements of certain fishing boat operators, but only to the extent such payment is in money and represents a share of the proceeds of the catch, (v) 6050N, relating to payments of royalties, or (vi) 6050W, relating to payments made in settlement of payment card and third party settlement transactions. Examples of payments that may be subject to backup withholding include interest, dividends, rents, royalties, commissions, non-employee compensation, and broker payments.

In general, a payment is determined to be a reportable payment, and therefore subject to backup withholding, without regard to any minimum amount which must be paid before an information return is required under the applicable information reporting statute.[17]

For payments required to be shown on a return under section 6041(a) or 6041A(a), relating to certain information at the source and payments of remuneration for services, a minimum amount generally must be paid before the payment is subject to backup withholding.[18] Such payments are treated as reportable payments, and therefore subject to backup withholding, only if (i) the aggregate amount of such payment and all previous payments described in section 6041(a) or 6041A(a) by the payor to the payee during such calendar year equals or exceeds $600, (ii) the payor was required under section 6041(a) or 6041A(a) to file an information return for the preceding calendar year with respect to payments to the payee, or (iii) during the preceding calendar year, the payor made reportable payments to the payee with respect to which amounts were required to be deducted and withheld under the backup withholding requirements. Backup withholding generally applies only to payments made to U.S. persons who have failed to provide the payor with a valid IRS Form W-9, *Request for Taxpayer Identification Number and Certification*; however, it may also apply to certain payments made to persons in the absence of valid documentation of foreign status. Backup withholding does not apply to payments made to exempt recipients, including tax-exempt organizations, government entities, and certain other entities.[19] Thus, a payor of reportable payments generally must request that a U.S. payee (other than certain exempt recipients) furnish a Form W-9 providing that person's name and TIN.[20]

[17] Sec. 3406(b)(4).

[18] Sec. 3406(b)(6).

[19] Sec. 3406(g); Treas. Reg. sec. 31.3406(g)-1.

[20] Treas. Reg. sec. 31.3406(h)-3.

Description of Proposal

The proposal increases the information reporting threshold under sections 6041 and 6041A to $5,000 in a calendar year, with the threshold amount (including the threshold for reporting of direct sales) to be indexed annually for inflation in calendar years after 2024.

The proposal also makes a conforming change to the dollar threshold in section 3406 with respect to information reporting required under sections 6041 and 6041A to align with the new $5,000 reporting threshold. Under the proposal, both the information reporting thresholds and the backup withholding thresholds are for transactions that equal or exceed $5,000 (indexed for inflation for calendar years after 2024).

Effective Date

The proposal applies with respect to payments made after December 31, 2023.

B. Restoration of Reporting Rule for Third Party Network Transactions

Present Law

Present law requires persons to file an information return concerning certain transactions with other persons.[21] The person filing an information return is also required to provide the person for whom the information return is being filed with a written statement showing the information that was reported to the IRS, which generally includes aggregate payments made, and the contact information for the payor.[22] These returns are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete.

Returns relating to payments made in settlement of payment card and third party network transactions

Since 2012 (for payments received in 2011), payment settlement entities are required to report to the IRS and to businesses that receive these payments the gross amount of payments made in settlement of payment card transactions and third party network transactions.[23]

Specifically, any payment settlement entity making a payment to a participating payee in settlement of reportable payment transactions must report annually to the IRS and to the participating payee the gross amount of such reportable payment transactions, as well as the name, address, and TIN of the participating payee.[24] A "reportable payment transaction" means any payment card transaction and any third party network transaction.[25]

A "payment settlement entity" means, in the case of a payment card transaction, a merchant acquiring entity (defined below) and, in the case of a third party network transaction, the third party settlement organization.[26] A "participating payee" means, in the case of a payment card transaction, any person who accepts a payment card as payment and, in the case of a third party network transaction, any person who accepts payment from a third party settlement

[21] Secs. 6041 through 6050Y.

[22] See, *e.g.*, sec. 6041(d).

[23] Sec. 6050W; Pub. L. No. 110-289 (2008), sec. 3091(a) enacted sec. 6050W, effective generally for returns for calendar years beginning after December 31, 2010.

[24] Sec. 6050W(a).

[25] Sec. 6050W(c)(1).

[26] Sec. 6050W(b).

organization in settlement of such transaction.[27] A "person" includes a governmental unit. A "person" generally does not include someone with a foreign address.[28]

Returns relating to payments made in settlement of payment card transactions

For purposes of the reporting requirement, the term "merchant acquiring entity" means a bank or other organization with the contractual obligation to make payment to participating payees in settlement of payment card transactions.[29] A "payment card transaction" means any transaction in which a payment card is accepted as payment.[30] A "payment card" is defined as any card (*e.g.*, a credit card or debit card) which is issued pursuant to an agreement or arrangement which provides for: (1) one or more issuers of such cards; (2) a network of persons unrelated to each other, and to the issuer, who agree to accept such cards as payment; and (3) standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept such cards as payment.[31] Thus, a bank that enrolls a business to accept credit cards and contracts with the business to make payment on credit card transactions must report to the IRS the business's gross credit card transactions for each calendar year on a Form 1099-K, *Payment Card and Third Party Network Transactions*. The bank also must provide a copy of the information return to the business.

Returns relating to payments made in settlement of third party network transactions

The statute also requires reporting on a third party network transaction. The term "third party network transaction" means any transaction which is settled through a third party payment network.[32] A "third party payment network" is defined as any agreement or arrangement: (1) that involves the establishment of accounts with a central organization by a substantial number of persons (generally considered to be more than 50) who are unrelated to such organization, provide goods or services, and agree to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (2) that provides for standards and mechanisms for settling such transactions; and (3) that guarantees persons providing goods or services pursuant to such agreement or arrangement will be paid for providing such goods or services.[33]

In the case of a third party network transaction, the payment settlement entity is the third party settlement organization, which is defined as the central organization which has the

[27] Sec. 6050W(d)(1).

[28] Sec. 6050W(d)(1)(B) and (C).

[29] Sec. 6050W(b)(2).

[30] For this purpose, the acceptance as payment of any account number or other indicia associated with a payment card also qualifies as a payment card transaction.

[31] Sec. 6050W(d)(2).

[32] Sec. 6050W(c)(3).

[33] Sec. 6050W(d)(3).

contractual obligation to make payment to participating payees of third party network transactions.[34] Thus, an organization generally is required to report if it provides a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network. However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have contractual agreements with sellers to use such network, is not required to report. Similarly, an agreement to transfer funds between two demand deposit accounts will not, by itself, constitute a third party network transaction.

De minimis payment exception

A third party payment network does not include any agreement or arrangement that provides for the issuance of payment cards as defined by the provision.[35] In addition, there is an exception for *de minimis* payments that applies to payments made by third party settlement organizations but not to payments made by merchant acquiring entities. For calendar years beginning after December 31, 2021, a third party settlement organization is required to report third party network transactions with any participating payee that exceed a minimum threshold of $600 in aggregate payments.[36] There is not a threshold requirement for the number of transactions. In addition, third party network transactions only include transactions for the provision of goods or services. Reporting is not required for other transactions, including personal gifts, charitable contributions, and reimbursements.

The previous exception for de minimis payments for calendar years beginning prior to January 1, 2022, provided that a third party settlement organization was not required to report unless the aggregate value of third party network transactions with respect to a participating payee for the year exceeds $20,000 and the aggregate number of such transactions with respect to a participating payee exceeds 200.

Rules regarding reporting requirements

There are also reporting requirements on intermediaries who receive payments from a payment settlement entity and distribute such payments to one or more participating payees.[37] Such intermediaries are treated as participating payees with respect to the payment settlement entity and as payment settlement entities with respect to the participating payees to whom the intermediary distributes payments. Thus, for example, in the case of a corporation that receives payment from a bank for credit card sales conducted at the corporation's independently-owned franchise stores, the bank is required to report to the corporation and to the IRS the gross amount

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[34] Sec. 6050W(b)(3).

[35] Sec. 6050W(d)(3).

[36] Sec. 6050W(e); Pub. L. No. 117-2, Title IX, sec. 9674, March 11, 2021, amending sec. 6050W(e), effective generally for returns for calendar years beginning after December 31, 2021.

[37] Sec. 6050W(b)(4).

of reportable payment transactions settled with respect to the corporation (notwithstanding the fact that the corporation does not accept payment cards and would not otherwise be treated as a participating payee). In turn, the corporation, as an intermediary, is required to report the gross amount of reportable payment transactions allocable to each franchise store. The bank has no reporting obligation with respect to payments made by the corporation to its franchise stores.

In addition, if a payment settlement entity contracts with a third-party facilitator to settle reportable payment transactions on behalf of the payment settlement entity, the third party facilitator is required to file the annual information return in lieu of the payment settlement entity.[38]

The payment settlement entity is required to file information returns to the IRS on or before February 28 (March 31 if filing electronically) of the year following the calendar year for which the returns must be filed.[39] Statements are required to be furnished to the participating payees on or before January 31 of the year following the calendar year for which the return was required to be made.[40]

The Secretary has exercised authority under these rules to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once.[41]

The reportable payment transactions subject to information reporting generally are subject to backup withholding requirements. In addition, the information reporting penalties apply for any failure to file a correct information return or furnish a correct payee statement with respect to the reportable payment transactions. Any person who is required to file an information return or furnish a payee statement but who fails to do so on or before the prescribed due date is subject to a penalty that varies based on when, if at all, the correct information return is filed or furnished. Penalties are imposed for failure to file the information return,[42] or furnish payee statements.[43] No penalty is imposed if the failure is due to reasonable cause.[44] Both the failure to file and failure to furnish penalties are adjusted annually to account for inflation.

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[38] Sec. 6050W(b)(4)(B); Treas. Reg. sec. 1.6050W-1(d)(2).

[39] Treas. Reg. sec. 1.6050W-1(g). Taxpayers that file these information returns that report reportable payment transactions are entitled to a 30-day automatic extension of time to file. Treas. Reg. sec. 1.6081-8(a) (effective for requests for extension of time to file certain information returns due after December 31, 2016).

[40] Sec. 6050W(f); Treas. Reg. sec. 1.6050W-1(h).

[41] Treas. Reg. sec. 1.6050W-1(a)(4)(ii).

[42] Sec. 6721.

[43] Sec. 6722. Section 6723 also imposes a penalty for failure to comply timely with a specified information reporting requirement. However, this penalty applies in narrow circumstances and is unlikely to apply to payment settlement entities under section 6050W. See Treas. Reg. sec. 301.6723-1(a)(4).

[44] Sec. 6724(a).

Description of Proposal

The proposal reverts to the previous *de minimis* reporting exception for third party settlement organizations. A third party settlement organization is not required to report unless the aggregate value of third party network transactions with respect to a participating payee for the year exceeds $20,000 and the aggregate number of such transactions with respect to a participating payee exceeds 200.

The obligations of a merchant acquiring entity are unchanged. For example, if a business that provides a web-based rental platform for short-term travelers is considered a third party settlement organization, it does not have to provide a Form 1099-K to property owners participating on its web-based platform who have received payments of $20,000 or less. Alternatively, if a company is considered a merchant acquiring entity, it must issue a Form 1099-K to all participating payees who have received payments of any amount starting with the first dollar.

Effective Date

The proposal applies to returns for calendar years beginning after December 31, 2021.

C. Modifications to Exclusion for Gain from Qualified Small Business Stock

Present Law

Exclusion for gain on sale of qualified small business stock

In general

A taxpayer other than a corporation may exclude a percentage of the gain from the sale of qualified small business stock acquired at original issue and held for at least five years.[45] In general, the percentage is 50 percent (60 percent for certain empowerment zone businesses) except as described below. The amount of gain eligible for the exclusion by an individual with respect to the stock of any C corporation is the greater of (1) ten times the taxpayer's basis in the stock, or (2) $10 million (reduced by the amount of eligible gain excluded by the taxpayer in prior years).[46] To qualify as a small business, before and immediately after the issuance, the aggregate gross assets (*i.e.*, cash plus aggregate adjusted basis of other property) held by the corporation may not exceed $50 million.[47] The corporation also must meet certain active trade or business requirements.[48] Only C corporation stock may qualify as qualified small business stock.[49] These rules are discussed further below.

The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax rates applicable to the net capital gain of individuals.[50] Seven percent of the excluded gain is an alternative minimum tax ("AMT") preference.[51]

Special rules for certain stock acquired after February 17, 2009

For qualified small business stock acquired after February 17, 2009, and before September 28, 2010, the percent of gain which may be excluded is increased to 75 percent ("75-percent exclusion rule").[52]

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[45] Sec. 1202(a)(1) and (2) and 1202(b)(2).

[46] Sec. 1202(b)(1).

[47] Sec. 1202(d)(1)(A), (B).

[48] Sec. 1202(c)(2).

[49] Sec. 1202(c)(1).

[50] Sec. 1(h)(4), (7).

[51] Sec. 57(a)(7).

[52] Sec. 1202(a)(3).

100-percent exclusion for certain stock acquired after September 27, 2010

For qualified small business stock acquired after September 27, 2010, the percent of gain which may be excluded is increased to 100 percent and the AMT preference does not apply ("100-percent exclusion rule").[53]

Rollover of gain from sale of small business stock

An individual may elect to roll over tax-free any gain realized on the sale of qualified small business stock held more than six months to the extent of the taxpayer's cost of purchasing other qualified small business stock within 60 days of the sale.[54]

Qualified small business and active business requirements

A qualified small business for purposes of the section 1202 exclusion means a domestic C corporation whose aggregate gross assets at all times after August 10, 1993, and before the issuance of the stock, do not exceed $50 million, and whose aggregate gross assets immediately after the stock issuance (taking into account amounts received in the issuance) does not exceed $50 million.[55]

Stock in a corporation is not treated as qualified small business stock unless (during substantially all of the taxpayer's holding period for the stock) the corporation meets active business requirements and is a C corporation.[56] The active business requirements[57] are met by a corporation[58] for any period if during the period the corporation uses at least 80 percent by value of its assets in the active conduct of one more qualified trades or businesses, which are defined by exclusion.[59]

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[53] Sec. 1202(a)(4). Qualified stock in empowerment zone businesses acquired after September 27, 2010, is subject to the 100-percent exclusion rule instead of the 60-percent exclusion rule. See sec. 1202(a)(4)(B).

[54] Sec. 1045(a).

[55] Sec. 1202(d). Aggregate gross assets means cash and the aggregated adjusted bases of other property of the corporation. Aggregation rules provide that all corporations that are members of the same parent-subsidiary controlled group are treated as one corporation for purposes of section 1202(d). A parent-subsidiary controlled group is defined by reference to section 1563(a), except that "more than 50 percent" is substituted for "at least 80 percent" in section 1563(a)(1) and section 1563(a)(4) does not apply. Sec. 1202(d)(3)(B).

[56] Sec. 1202(c)(2).

[57] Sec. 1202(e).

[58] It must be an eligible corporation, meaning it is not a domestic international sales corporation ("DISC") or former DISC, regulated investment company ("RIC"), real estate investment trust ("REIT"), real estate mortgage investment conduit ("REMIC"), or cooperative. Sec. 1202(e)(4).

[59] Excluded trades or businesses are: (A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is

Description of Proposal

The proposal makes three modifications to the section 1202 gain exclusion.

Phased increase in exclusion for gain from qualified small business stock

The first modification shortens the holding period required to exclude any gain from the sale of qualified small business stock acquired after the date of enactment of the proposal and allows 50 percent, 75 percent, or 100 percent of the gain to be excluded, depending on the holding period of the stock. Specifically, the exclusion percentage is 50 percent for such qualified small business stock held for at least three years, 75 percent for such qualified small business stock held for at least four years, and 100 percent for such qualified small business stock held for five years or more. Further, in the case of such qualified small business stock, the AMT preference[60] does not apply. The applicable percentages of gain which may be excluded are as follows.

<table>
<tr><th>Stock acquisition date</th><th>Holding period</th><th>Exclusion percentage</th><th>AMT preference applies?</th></tr>
<tr><td rowspan="3">After the date of enactment of the proposal</td><td>At least three years</td><td>50 percent</td><td>No</td></tr>
<tr><td>At least four years</td><td>75 percent</td><td>No</td></tr>
<tr><td>Five years or more</td><td>100 percent</td><td>No</td></tr>
<tr><td>After September 27, 2010, and on or before the date of enactment of the proposal</td><td>More than five years</td><td>100 percent</td><td>No</td></tr>
<tr><td>After February 17, 2009, and before September 28, 2010</td><td>More than five years</td><td>75 percent</td><td>Yes</td></tr>
<tr><td>Before February 18, 2009</td><td>More than five years</td><td>50 percent[1]</td><td>Yes</td></tr>
</table>

[1] 60 percent for certain empowerment zone businesses.

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the reputation or skill of one or more of its employees; (B) any banking, insurance, financing, leasing, investing, or similar business; (C) any farming business; (D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A; and (E) any business of operating a hotel, motel, restaurant, or similar business. Sec. 1202(e)(3).

[60] Alternative minimum taxable income ("AMTI") is equal to a taxpayer's regular taxable income modified by AMT tax preference items and various AMT adjustments. AMT tax preference items are deductions or exclusions that are allowed in computing regular taxable income but that are not allowed in computing AMTI (for example, the exclusion of gain from qualified small business stock). Secs. 55, 56, 57, and 58.

Tacking holding period of convertible debt instruments

The second modification provides a holding period tacking rule with respect to a qualified convertible debt instrument. In the case of stock in a corporation acquired by the taxpayer without gain recognition solely through the conversion of a qualified convertible debt instrument, the stock is treated as having been held during the period that the qualified convertible debt instrument was held. If the bond or other evidence of indebtedness that is so converted is a qualified convertible debt instrument, then the stock so acquired is treated as qualified small business stock in the hands of the taxpayer. To be a qualified convertible debt instrument, a bond or other evidence of indebtedness must meet the requirements that it is originally issued by the corporation to the taxpayer and that it is convertible into stock of the corporation. It must also meet the requirements that the issuer of the bond or other evidence of indebtedness is a qualified small business from issuance until conversion, and that during substantially all of the period that the taxpayer holds the bond or evidence of indebtedness, the corporation meets the section 1202 active business requirements.

Gain exclusion allowed with respect to qualified small business stock in S corporations

The third modification under the proposal extends the exclusion for section 1202 gains to stock in S corporations. Thus, stock of an S corporation can be qualified small business stock under section 1202 if the requirements of such section are met. Ownership of S corporation stock is taken into account in determining the aggregate gross assets of a controlled group of corporations.[61] If gain is excluded under section 1202 upon disposition of S corporation stock, the disposition is not a fully taxable transaction for purposes of the passive loss rule for dispositions of an entire interest in any passive activity.[62] Thus, suspended losses from the S corporation will not be allowed in full when the taxpayer disposes of the S corporation stock and excludes any gain under section 1202. The requirements of section 1202 are applied at the S corporation level.

Effective Date

The proposal relating to the phased increase in the gain exclusion percentage is generally effective for stock acquired after the date of enactment. However, the continued exclusion of gain from the sale of qualified small business stock from treatment as an AMT preference is

[61] Sec. 1202(d)(1) – (3).

[62] Sec. 469(g)(1)(A). The passive loss rules of section 469 limit deductions and credits from passive trade or business activities. They apply to individuals, estates and trusts, and closely-held corporations. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Sec. 469(a) and (d). Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. Sec. 469(b). The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person. Sec. 469(g).

effective as if included in the enactment of section 2011 of the Creating Small Business Jobs Act of 2010[63] (*i.e.*, for stock issued after September 27, 2010).

The proposal relating to tacking the holding period of certain convertible debt instruments is effective for debt instruments originally issued after the date of enactment.

The proposal relating to allowing the section 1202 exclusion for gain on certain stock of an S corporation is effective for stock acquired after the date of enactment.

[63] Title II of Pub. L. No. 111-240, September 27, 2010.

D. Increase in Limitations on Expensing of Depreciable Business Assets

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[64] The period for depreciation or amortization generally begins when the asset is placed in service by the taxpayer.[65] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention.[66]

Election to expense certain depreciable business assets

Subject to certain limitations, a taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[67] The maximum amount a taxpayer may expense is $1,000,000 of the cost of qualifying property placed in service for the taxable year.[68] The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,500,000.[69]

The $1,000,000 and $2,500,000 amounts are indexed for inflation for taxable years beginning after 2018.[70] For taxable years beginning in 2023, the total amount that may be expensed is $1,160,000, and the phase-out threshold amount is $2,890,000.[71] For example, assume that during 2023 a calendar year taxpayer purchases and places in service $4,000,000 of section 179 property. The $1,160,000 section 179(b)(1) dollar amount for 2023 is reduced by the

[64] See secs. 263(a) and 167. In general, only the tax owner of property (*i.e.*, the taxpayer with the benefits and burdens of ownership) is entitled to claim tax benefits such as cost recovery deductions with respect to the property. In addition, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, sec. 280A.

[65] See Treas. Reg. secs. 1.167(a)-10(b), -3, -14, and 1.197-2(f). See also Treas. Reg. sec. 1.167(a)-11(e)(1)(i).

[66] Sec. 168.

[67] In the case of property purchased and placed in service by a partnership (or S corporation), the determination of whether the property is section 179 property is made at the partnership (or corporate) level, and the election to expense is made by the partnership (or S corporation). Treas. Reg. sec. 1.179-1(h).

[68] Sec. 179(b)(1).

[69] Sec. 179(b)(2).

[70] Sec. 179(b)(6).

[71] Section 3.25 of Rev. Proc. 2022-38, 2022-45 I.R.B. 445.

excess section 179 property cost amount of $1,110,000 ($4,000,000 – $2,890,000). The taxpayer's 2023 section 179 expensing limitation is $50,000 ($1,160,000 – $1,110,000).[72]

In general, qualifying property is defined as depreciable tangible personal property, off-the-shelf computer software, and qualified real property[73] that is purchased for use in the active conduct of a trade or business.[74] Qualifying property excludes any property described in section 50(b) (other than paragraph (2) thereof[75]).[76]

Qualified real property includes (1) qualified improvement property[77] and (2) any of the following improvements to nonresidential real property that are placed in service by the taxpayer after the date such nonresidential real property was first placed in service: roofs; heating, ventilation, and air-conditioning ("HVAC") property;[78] fire protection and alarm systems; and security systems.[79]

Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F.[80] For sport utility vehicles above the 6,000 pound weight rating and not more than the 14,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for

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[72] The taxpayer's remaining basis in the property may be eligible for bonus depreciation under section 168(k). See Treas. Reg. sec. 1.168(k)-1(a)(2)(iii).

[73] At the election of the taxpayer. Sec. 179(d)(1)(B)(ii). See sec. 3.02 of Rev. Proc. 2019-08, 2019-03 I.R.B. 347, for guidance regarding the election to treat qualified real property as section 179 property.

[74] Sec. 179(d)(1). If section 179 property is not used predominantly in a trade or business of the taxpayer at any time before the end of its recovery period, recapture rules apply. See sec. 179(d)(10) and Treas. Reg. sec. 1.179-1(e).

[75] Thus, section 179 property includes certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging (*e.g.*, beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let). See Treas. Reg. sec. 1.48-1(h).

[76] Sec. 179(d)(1) flush language. Property described in section 50(b) (other than paragraph (2) thereof) is generally property used outside the United States, property used by certain tax-exempt organizations, and property used by governmental units and foreign persons or entities (*i.e.*, certain property not eligible for the investment tax credit).

[77] As defined in sec. 168(e)(6).

[78] HVAC property includes all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes and ducts. Treas. Reg. sec. 1.48-1(e)(2). See also sec. 3.01(1)(b)(iii)(B) of Rev. Proc. 2019-08, 2019-03 I.R.B. 347.

[79] Sec. 179(e).

[80] For a description of section 280F, see Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), December 2018, pp. 128-130. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

any taxable year under section 179 is $25,000 (the "sport utility vehicle limitation").[81] The $25,000 amount is indexed for inflation for taxable years beginning after 2018. For taxable years beginning in 2023, the sport utility vehicle limitation is $28,900.[82]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to section 179).[83] Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations). In the case of a partnership (or S corporation), the section 179 limitations are applied at the partnership (or corporate) and partner (or shareholder) levels.[84]

Amounts expensed under section 179 are allowed for both regular tax and the alternative minimum tax.[85] However, no general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[86] In addition, if a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted under section 179 reduce corporate earnings and profits ratably over a five-year period.[87]

An expensing election is made under rules prescribed by the Secretary.[88] In general, any election made under section 179, and any specification contained therein, may be revoked by the

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[81] Sec. 179(b)(5). For this purpose, a sport utility vehicle is defined to exclude any vehicle that: (1) is designed for more than nine individuals in seating rearward of the driver's seat; (2) is equipped with an open cargo area, or a covered box not readily accessible from the passenger compartment, of at least six feet in interior length; or (3) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

[82] Section 3.25 of Rev. Proc. 2022-38, 2022-45 I.R.B. 445.

[83] Sec. 179(b)(3). See also Treas. Reg. sec. 1.179-2(c)(6)(iv) (wages, salaries, tips, and other compensation received by a taxpayer as an employee are included in the taxpayer's aggregate amount of taxable income derived from the active conduct of a trade or business).

[84] Sec. 179(d)(8).

[85] See the Senate Finance Committee Report to Accompany H.R. 3838, Tax Reform Act of 1986, S. Rep. No. 99-313, May 29, 1985, p. 522. See also the Instructions for Form 6251, *Alternative Minimum Tax - Individuals* (2022), p. 5.

[86] Sec. 179(d)(9).

[87] Sec. 312(k)(3)(B).

[88] Sec. 179(c)(1). Such election may be made on an amended return. See sec. 3.02 of Rev. Proc. 2017-33, 2017–19 I.R.B. 1236; and sec. 3.02 of Rev. Proc. 2019-08, 2019-03 I.R.B. 347.

taxpayer with respect to any property without the consent of the Commissioner.[89] Such revocation, once made, is irrevocable.

Description of Proposal

The proposal increases the maximum amount a taxpayer may expense under section 179 to $2,500,000, and increases the phase-out threshold amount to $4,000,000. Thus, the proposal provides that the maximum amount a taxpayer may expense for taxable years beginning after 2023 is $2,500,000 of the cost of section 179 property placed in service for the taxable year. The $2,500,000 amount is reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during the taxable year exceeds $4,000,000. The $2,500,000 and $4,000,000 amounts are indexed for inflation for taxable years beginning after 2024.

For example, assume that during 2024 a calendar year taxpayer purchases and places in service $4,500,000 of section 179 property. The $2,500,000 section 179(b)(1) dollar amount for 2024 will be reduced by the excess section 179 property cost amount of $500,000 ($4,500,000 - $4,000,000 limitation). Thus, the taxpayer's 2024 section 179 expensing limitation will be $2,000,000 ($2,500,000 dollar limitation - $500,000 excess). The remaining $2,500,000 ($4,500,000 - $2,000,000 section 179 expense) may be eligible for bonus depreciation under section 168(k), depending on the types of assets placed in service.

Effective Date

The proposal applies to property placed in service in taxable years beginning after December 31, 2023.

[89] Sec. 179(c)(2).

E. Establishment of Special Rules for Capital Gains Invested in Rural Opportunity Zones, and Reporting on Qualified Opportunity Funds and Qualified Rural Opportunity Funds

Present Law

Overview

Investments in qualified opportunity zones funds are entitled to three tax benefits, at the taxpayer's election: (1) a temporary deferral of the capital gain reinvested in the qualified opportunity zone (the "rollover gain"), (2) a permanent 10 or 15 percent reduction in the amount of such gain that must be recognized if the investment is held for five or seven years, respectively, and (3) a permanent exclusion of future gains resulting from the investment in the opportunity zone if the investment is held for at least 10 years.[90] To qualify, the rollover gain is generally required to be invested in the qualified opportunity fund during a 180-day period that begins on the date of the sale or exchange that generated the gain.

A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property. The number of communities designated as opportunity zones may be up to 25 percent of the total number of a State's low-income communities, as designated by the governor of a State.[91]

A taxpayer may elect to temporarily defer and partially exclude capital gains from gross income to the extent that the taxpayer invests the amount of those gains in a qualified opportunity fund. The maximum amount of the deferred gain is equal to the amount invested in a qualified opportunity fund by the taxpayer during the 180-day period beginning on the date of the asset sale that produced the gain to be deferred. Capital gains in excess of the deferred amount must be recognized and included in gross income as under present law.

In the case of any investment in a qualified opportunity fund, only a portion of which consists of the investment of gain with respect to which an election is made, such investment is treated as two separate investments, consisting of one investment that includes only amounts to which the election applies (herein "deferred-gain investment"), and a separate investment consisting of other amounts. The temporary deferral and permanent exclusion provisions do not apply to the separate investment. For example, if a taxpayer sells stock at a gain and invests the entire sales proceeds (capital and return of basis) in a qualified opportunity zone fund, an election may be made only with respect to the capital gain amount. No election may be made with respect to amounts attributable to a return of basis, and no special tax benefits apply to such amounts.

The basis of a deferred-gain investment in a qualified opportunity zone fund immediately after its acquisition is zero. If the deferred-gain investment in the qualified opportunity zone fund is held by the taxpayer for at least five years, the basis in the deferred-gain investment is

[90] Sec. 1400Z-2.

[91] Sec. 1400Z-1.

increased by 10 percent of the original deferred gain. If the opportunity zone asset or investment is held by the taxpayer for at least seven years, the basis in the deferred gain investment is increased by an additional five percent of the original deferred gain. Some or all of the deferred gain is recognized on the earlier of (i) the date on which the qualified opportunity zone investment is disposed of, or (ii) December 31, 2026. The amount of gain recognized is the excess of (i) the lesser of the amount deferred or the current fair market value of the investment (taking into account any increases at the end of five or seven years), over (ii) the taxpayer's basis in the investment. The taxpayer's basis in the investment is increased by the amount of gain recognized. No election under the provision may be made after December 31, 2026, or with respect to a disposition if an election previously made is in effect.

The post-acquisition capital gains on deferred-gain investments in opportunity zone funds that are held for at least 10 years are excluded from gross income. Specifically, in the case of the sale or exchange of an investment in a qualified opportunity zone fund held for more than 10 years, a further election is allowed by the taxpayer to modify the basis of such deferred-gain investment in the hands of the taxpayer to be the fair market value of the deferred-gain investment at the date of such sale or exchange.

In the case of a fund organized as a pass-through entity, investors recognize gains and losses associated with both deferred-gain and nondeferred-gain investments in the fund, under the rules generally applicable to pass-through entities. Thus, for example, investor-partners in a fund organized as a partnership would recognize income and increase their basis with respect to their distributive share of the fund's taxable income.

Qualifying geography

In order to obtain the deferral and exclusion benefits of the qualified opportunity zones provisions, the taxpayer must invest in qualified opportunity zones. The Code allows for the designation of certain low-income community population census tracts as qualified opportunity zones.

The term "low-income communities" has the same meaning as that used in the new markets tax credit provisions under section 45D. For both the new markets tax credit provisions and the opportunity zone provisions, a low-income community is either a population census tract that meets certain criteria, or specific areas designated by the Secretary. Specifically, a low-income community is a population census tract with either (1) a poverty rate of at least 20 percent, or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, this does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary is also authorized to designate "targeted populations" as low-income communities. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a nonmetropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide nonmetropolitan area median family income. A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the qualified opportunity zone rules if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

In addition to low-income communities, a limited number of other census tracts that are not low-income communities can be so designated if they are contiguous to a designated low-income community and the median family income of such tracts does not exceed 125 percent of the median family income of the contiguous low-income community. The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the tenth calendar year beginning on or after the date of designation.

The chief executive officer of the State, possession, or the District of Columbia (*i.e.*, Governor, or mayor in the case of the District of Columbia) may submit nominations for a limited number of qualified opportunity zones to the Secretary for certification and designation. If the number of low-income communities in a State is less than 100, the Governor may designate up to 25 tracts, otherwise the Governor may designate tracts not exceeding 25 percent of the number of low-income communities in the State. There is a special rule for Puerto Rico such that each population census tract in Puerto Rico that is a low-income community is deemed certified and designated as a qualified opportunity zone, effective on the date of enactment of Public Law 115-97 (*i.e.*, December 22, 2017).

Project structure and steps required to obtain benefits

As discussed, the opportunity zones provisions allow a taxpayer to make an election when investing in a qualified opportunity fund that results in three tax benefits. To take advantage of the election, a taxpayer generally sells capital assets then contributes the realized gain to a qualified opportunity fund within 180 days of the sale. The taxpayer can contribute funds in excess of the realized gain, but those funds will not be eligible for the tax benefits. The qualified opportunity fund contributes the amount received to a directly owned qualified opportunity zone business, a corporation in exchange for qualified opportunity zone stock, or a partnership in exchange for a qualified opportunity zone partnership interest.

A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified

opportunity zone property. Qualified opportunity zone property means: (1) qualified opportunity zone stock, (2) qualified opportunity zone partnership interest, and (3) qualified opportunity zone business property.

If a qualified opportunity fund fails to meet the 90 percent requirement, unless the fund establishes reasonable cause, the fund is required to pay a monthly penalty equal to the excess of the amount equal to 90 percent of its aggregate assets, over the aggregate amount of qualified opportunity zone property held by the fund multiplied by the underpayment rate in the Code. If the fund is a partnership, the penalty is taken into account proportionately as part of each partner's distributive share.

Qualified opportunity zone stock consists of stock in a domestic corporation that is a qualified opportunity zone business. There are three requirements that must be met for property to be considered qualified opportunity zone stock. First, the stock must be acquired at original issuance (directly or indirectly through an underwriter) solely for cash after December 31, 2017. Second, the corporation must have been a qualified opportunity zone business when the stock was issued (or, for a new corporation, was being organized to be a qualified opportunity zone business). Third, the corporation must qualify as a qualified opportunity zone business during substantially all of the qualified opportunity fund's holding period for the stock.

Qualified opportunity zone partnership interest consists of capital or profits interests in a domestic partnership that is a qualified opportunity zone business. There are three requirements that must be met for property to be considered a qualified opportunity zone partnership interest. First, the interest must be acquired from the partnership solely for cash after December 31, 2017. Second, the partnership must have been a qualified opportunity zone business when the interest was acquired (or, for a new partnership, was being organized to be a qualified opportunity zone business). Third, the partnership must qualify as a qualified opportunity zone business during substantially all of the qualified opportunity fund's holding period for the interest.

Qualified opportunity zone business property consists of tangible property used in the trade or business of a qualified opportunity fund or qualified opportunity zone business. There are three main requirements that must be met for property to be considered qualified opportunity zone business property. First, the property must be acquired by purchase after December 31, 2017. Second, the original use of the property in the qualified opportunity zone must begin with the qualified opportunity fund or qualified opportunity zone business, or the qualified opportunity fund or qualified opportunity zone business must substantially improve the property. Only new or substantially improved property qualifies as opportunity zone business property. Third, substantially all of the property must be in a qualified opportunity zone during substantially all of the qualified opportunity fund's or qualified opportunity zone business's holding period for the property. Property is treated as substantially improved only if capital expenditures on the property in the 30 months after acquisition exceed the property's adjusted basis on the date of acquisition.

A qualified opportunity zone business is any trade or business in which substantially all of the underlying value of the tangible property owned or leased by the business is qualified opportunity zone business property.

In addition, (1) at least 50 percent of the total gross income of the trade or business must be derived from the active conduct of business in the qualified opportunity zone, (2) a substantial portion of the business's intangible property must be used in the active conduct of business in the qualified opportunity zone, and (3) less than five percent of the average of the aggregate adjusted bases of the property of the business is attributable to nonqualified financial property. Nonqualified financial property means debt, stock, partnership interests, annuities, and derivative financial instruments (including options, futures, forward contracts, and notional principal contracts), other than (1) reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of no more than 18 months, and (2) accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered or from the sale of inventory property.[92] The business cannot be a golf course, country club, massage parlor, hot tub or suntan facility, racetrack or other facility used for gambling, or store whose principal business is the sale of alcoholic beverages for consumption off premises.[93]

Tangible property that ceases to be qualified opportunity zone business property continues to be treated as qualified opportunity zone business property for the lesser of five years after the date on which such tangible property ceases to be so qualified, or the date on which such tangible property is no longer held by the qualified opportunity zone business.

Information reporting and data reporting

The Code does not specifically provide rules for information reporting or data reporting from qualified opportunity funds or qualified opportunity zone businesses. The Code provides the Secretary with the authority to prescribe regulations as necessary to carry out the purposes of the section, including (i) rules for the certification of qualified opportunity funds, (ii) rules to ensure a qualified opportunity fund has a reasonable period of time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, and to reinvest proceeds received from the sale or disposition of qualified opportunity zone property, and (iii) rules to prevent abuse.[94]

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[92] Sec. 1397C(e).

[93] Treas. Reg. sec. 1.400Z2(d)-1.

[94] Sec. 1400Z-2(e)(4). Three forms require reporting relating to opportunity zones: Form 8996, *Qualified Opportunity Fund*, Form 8949, *Sales and Other Dispositions of Capital Assets, and Form 8997, Initial and Annual Statement of Qualified Opportunity Fund Investments.* A corporation or partnership organized as a qualified opportunity fund uses Form 8996 to certify that it is organized to invest in qualified opportunity zone property and to report that the qualified opportunity fund meets the investment standard of the Code or to calculate the penalty if it fails to meet the investment standard. Taxpayers use Form 8949 to report the election to defer capital gain invested in a qualified opportunity fund. Taxpayers use Form 8997 to report qualified opportunity fund investments held at the beginning and end of the year, capital gains for the year that were deferred, and investments disposed of during the year.

Description of Proposal

In general

The proposal establishes a new type of opportunity zone, called a qualified rural opportunity zone. The proposal also requires information reporting from qualified opportunity funds, qualified rural opportunity funds, qualified opportunity zone businesses, and qualified rural opportunity zone businesses, and imposes penalties for failing to comply with these requirements. Finally, the proposal requires the Secretary to publicly report various data on qualified opportunity funds and qualified rural opportunity funds.

Qualified rural opportunity zones

The proposal creates a new category of qualified opportunity zones called qualified rural opportunity zones. Qualified rural opportunity zones are defined as any population census tract if: (i) such census tract is located in a rural county, and (ii) is in persistent poverty (as determined by the Bureau of the Census using the same methodology and data as used in the May 2023 report of such Bureau entitled "Persistent Poverty in Counties and Census Tracts"). Where any portion of a State is not within a county, the Secretary shall designate an area which is the equivalent of a county under a rule similar to section 143(k)(2)(D). The term "rural county" means any county if more than 50 percent of the census blocks which comprise such county are rural blocks (as determined by the Bureau of the Census as of the date of enactment of this proposal).

As with qualified opportunity zones, investments in qualified rural opportunity zones funds are entitled to three tax benefits, at the taxpayer's election: (1) a temporary deferral of the capital gain reinvested in the qualified opportunity zone (the "rollover gain"), (2) a permanent 10 or 15 percent reduction in the amount of such gain that must be recognized if the investment is held for five or seven years, respectively, and (3) a permanent exclusion of future gains resulting from the investment in the opportunity zone if the investment is held for at least 10 years. To qualify, the rollover gain is generally required to be invested in the qualified rural opportunity fund during a 180-day period that begins on the date of the sale or exchange that generated the gain.

Under the proposal, there are three main differences between the rules for qualified opportunity zones and those for qualified rural opportunity zones. First, the qualified opportunity zone rules provide that some or all of the deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of or December 31, 2026. The qualified opportunity zone rules also provide that no election may be made after December 31, 2026. The qualified rural opportunity zone rules, on the other hand, provide that some or all of the deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of or December 31, 2032. In addition, the qualified rural opportunity zones rules provide that no election may be made after December 31, 2032.

Second is the difference in the date by which stock, a partnership interest, and property must be acquired to qualify as qualified rural opportunity zone stock, qualified rural opportunity zone partnership interest and qualified rural opportunity zone business property, respectively.

For purposes of the qualified opportunity zone rules, stock is to be acquired at original issuance (directly or indirectly through an underwriter) solely for cash after December 31, 2017, a partnership interest is to be acquired from the partnership solely for cash after December 31, 2017, and property is to be acquired by purchase after December 31, 2017. In contrast, for purposes of the qualified rural opportunity zone rules, stock, a partnership interest, and property is required to be acquired after December 31, 2023.

Third, in order to obtain the deferral and exclusion benefits of the qualified rural opportunity zones provisions, the taxpayer must invest in qualified rural opportunity zones. Unlike the rules with respect to qualified opportunity zones, however, the proposal does not provide for the chief executive officer of the State to submit nominations for qualified rural opportunity zones to the Secretary for certification and designation.

Information reporting requirements for qualified opportunity funds, qualified rural opportunity funds, qualified opportunity zone businesses, and qualified rural opportunity zone businesses

The proposal requires information reporting from (i) qualified opportunity funds and qualified rural opportunity funds, and (ii) qualified opportunity zone businesses and qualified rural opportunity zone businesses. The proposal requires that the qualified opportunity funds and qualified rural opportunity funds electronically file their returns. The proposal states that any term used in these information reporting sections has the same meaning as used in current law governing qualified opportunity zones.

Qualified opportunity funds

The proposal requires every qualified opportunity fund to file an annual return (at such time and in such manner as the Secretary may prescribe) containing the following information:

- the name, address, and TIN of the qualified opportunity fund;
- whether the qualified opportunity fund is organized as a corporation or a partnership;
- the value of the total assets held by the qualified opportunity fund as of each date described in section 1400Z-2(d)(1);
- the value of all qualified opportunity zone property held by the qualified opportunity fund on each such date;
- with respect to each investment held by the qualified opportunity fund in qualified opportunity zone stock or a qualified opportunity zone partnership interest:
    - the name, address, and TIN of the corporation in which such stock is held or the partnership in which such interest is held,
    - each North American Industry Classification System ("NAICS") Code that applies to the trades or businesses conducted by such corporation or partnership,
    - the population census tracts in which the qualified opportunity zone business property of such corporation or partnership is located,

- the amount of the investment in such stock or partnership interest as of each date described in section 1400Z-2(d)(1),
- the value of tangible property held by such corporation or partnership on each date which is owned by such corporation or partnership,
- the approximate number of residential units (if any) for any real property held by such corporation or partnership, and
- the approximate average monthly number of full-time equivalent employees of such corporation or partnership for the year (within numerical ranges identified by the Secretary) or such other indication of the employment impact of such corporation or partnership as determined appropriate by the Secretary;

- with respect to the items of qualified opportunity zone business property held by the qualified opportunity fund:
  - the NAICS Code that applies to the trades or businesses in which such property is held,
  - the population census tract in which the property is located,
  - whether the property is owned or leased,
  - the aggregate value of the items of qualified opportunity zone property held by the qualified opportunity fund as of such date described in section 1400Z-2(d)(1), and
  - in the case of real property, number of residential units (if any);
- the approximate average monthly number of full-time equivalent employees for the year of the trades or businesses of the qualified opportunity fund in which qualified opportunity zone business property is held (within numerical ranges identified by the Secretary) or such other indication of the employment impact of such trades or businesses as determined appropriate by the Secretary;
- with respect to each person who disposed of an investment in the qualified opportunity fund during the year:
  - the name and TIN of such person,
  - the date(s) on which the investment disposed was acquired, and
  - the date(s) on which any such investment was disposed and the amount of the investment disposed; and
- such other information as the Secretary may require.

For purposes of this information reporting requirement, the term "full-time equivalent employees" means with respect to any month, the sum of: (i) the number of full-time employees (as defined in section 4980H(c)(4)), for the month plus (ii) the number of employees determined (under rules similar to the rules of section 4980H(e)(2)(E)) by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120.

Every qualified opportunity fund required to file an information return with the IRS as discussed above is also required to provide a written statement to each person whose name is required to be provided on the return because the person disposed of an investment in the qualified opportunity fund during the year. The written statement is required to show:

- the name, address and phone number of the information contact of the qualified opportunity fund required to file the return, and
- the following information with respect to the person who disposed of the investment:
    - the name and TIN of the person,
    - the date(s) on which the investment disposed was acquired, and
    - the date(s) on which any such investment was disposed of and the amount of the investment disposed of.

The proposal treats this statement as a payee statement under the Code, subject to information reporting penalties as discussed below.

<u>Qualified rural opportunity funds</u>

The proposal applies the above information reporting requirements for qualified opportunity funds to qualified rural opportunity funds. Thus, qualified rural opportunity funds are required to file an annual return with the IRS and provide statements to persons who dispose of their investment in the qualified rural opportunity fund during the year.

<u>Qualified opportunity zone businesses</u>

The proposal requires every applicable qualified opportunity zone business to provide to the qualified opportunity fund a written statement in such manner and setting forth such information as the Secretary may prescribe for purposes of enabling the qualified opportunity fund to meet its information return reporting requirements. The term "applicable qualified opportunity zone business" means any qualified opportunity zone business: (i) which is a trade or business of a qualified opportunity fund, (ii) in which a qualified opportunity fund holds qualified opportunity zone stock, or (iii) in which a qualified opportunity fund holds a qualified opportunity zone partnership interest. The proposal treats this statement as a payee statement under the Code, subject to information reporting penalties as discussed below.

Qualified rural opportunity zone businesses

The proposal applies the information reporting requirements for qualified opportunity zone businesses to qualified rural opportunity zone businesses. Thus, applicable qualified rural opportunity zone businesses are required to provide to the qualified rural opportunity fund a written statement in such manner and setting for such information as the Secretary may prescribe.

Penalties for failure to comply with information reporting requirements for qualified opportunity funds and qualified rural opportunity funds

The proposal provides penalties for qualified opportunity funds and qualified rural opportunity funds that do not comply with appropriate information reporting requirements. The proposal also provides penalties for qualified opportunity zone businesses and qualified rural opportunity zone businesses that do not furnish the required statements to the qualified opportunity funds and the qualified rural opportunity funds.

Qualified opportunity funds

Any qualified opportunity fund that fails to file a complete and correct information return in the time and manner required must pay a penalty of $500 per day, subject to a maximum penalty with respect to one return of $10,000. The maximum penalty is increased to $50,000 for qualified opportunity funds with gross assets (determined on the last day of the taxable year) in excess of $10,000,000 ("large funds"). For intentional disregard of the reporting information requirements, the penalty is $2,500 per day, subject to a maximum penalty of $50,000, or $250,000 in the case of large funds. The penalty amounts are subject to inflation adjustments for returns required to be filed after calendar year 2023.

Qualified opportunity funds and qualified opportunity fund businesses

The proposal also provides penalties for: (i) failure of the qualified opportunity fund to provide the written statement to each person whose name is required to be provided on the return because the person disposed of an investment in the qualified opportunity fund during the year, and (ii) failure of the qualified opportunity zone business to provide the written statement in such manner and setting forth such information as the Secretary may prescribe for purposes of enabling the qualified opportunity fund to meet its information return reporting requirements. The proposal treats these statements as payee statements under the Code, and as such, subjects the qualified opportunity fund and the qualified opportunity fund business to the current information reporting penalties for failures relating to payee statements. [95]

[95] A person who fails to furnish correct written statements to recipients of payments for which information reporting is required is subject to a penalty of $250 for each statement with respect to which such a failure occurs, up to a maximum of $3,000,000 in any calendar year, adjusted for inflation. Sec. 6722. These amounts are subject to inflation adjustments under section 6722(f). For information statements due in calendar year 2023, the penalty amount is $290, up to a maximum of $3,532,500 per year. For information statements due in calendar year 2024, the penalty amount is $310, up to a maximum of $3,783,000 per year. The penalties are reduced if the failure is corrected within a specific amount of time. Sec. 6722(b). The penalties are waived if a person establishes that any

Qualified rural opportunity funds and qualified rural opportunity zone businesses

The proposal also imposes the penalties discussed above on the qualified rural opportunity funds for (i) failure to file a complete and correct information return in the time and manner required, and (ii) failure to provide the written statement to each person whose name is required to be provided on the return because the person disposed of an investment in the qualified rural opportunity fund during the year. And the proposal imposes the penalties discussed above on the qualified rural opportunity zone businesses for failure of the qualified rural opportunity zone business to provide the written statement in such manner and setting forth such information as the Secretary may prescribe for purposes of enabling the qualified rural opportunity fund to meet its information return reporting requirements.

Reporting of data on opportunity zone tax incentives

As soon as practical after the date of enactment, and annually thereafter, the Secretary or the Secretary's delegate, in consultation with the Director of the Bureau of the Census and such other agencies as the Secretary determines, are required to publish a report on qualified opportunity funds. The report is required to include the following information:

(i) the number of qualified opportunity funds;

(ii) the aggregate dollar amount of assets held in qualified opportunity funds;

(iii) the aggregate dollar amount of investments made by qualified opportunity funds in qualified opportunity fund property, stated separately for each NAICS Code;

(iv) the percentage of population census tracts designated as qualified opportunity zones that have received qualified opportunity fund investments;

(v) for each population census tract designated as a qualified opportunity zone, the approximate average monthly number of full-time equivalent employees of the qualified opportunity zone businesses in such qualified opportunity zone for the preceding 12-month period (within numerical wages identified by the Secretary) or other indication of the employment impact of such qualified opportunity fund businesses as determined by the Secretary;

(vi) the percentage of the total amount of investments made by qualified opportunity funds in (1) qualified opportunity zone property which is real property, and (2) other qualified opportunity zone property;

(vii) for each population census tract, the aggregate approximate number of residential units resulting from investments made by qualified opportunity funds in real property; and

failure was due to reasonable cause and not willful neglect. Sec. 6724(a). These failure to furnish penalties are reduced for small businesses (sec. 6722(d)) and increased for failures due to intentional disregard (sec. 6722(e)).

(viii) the aggregate dollar amount of investments made by qualified opportunity funds in each population census tract.

In addition to the report described above, for the sixth year after the date of enactment, the Secretary is required to include in the report the impacts and outcomes of a designation of a population census tract as a qualified opportunity zone as measured by economic indicators, such as job creation, poverty reduction, new business starts, and other metrics as determined by the Secretary.

Also, in the sixth year or the 11th year after the date of enactment, the Secretary is required to include in the report, for population census tracts designated as a qualified opportunity zone, a comparison (based on aggregate information) of the factors described below: (i) between the five-year period ending on the date of the enactment of Public Law 115-97 (*i.e.*, December 22, 2017) and the most recent five-year period for which data is available; and (ii) for the most recent five-year period for which data is available between such population census tracts and similar population census tracts that were not designated as a qualified opportunity zone. The Secretary is permitted to combine population census tracts into such groups as the Secretary determines appropriate for purposes of making comparisons.

The factors are:

(i) the unemployment rate;

(ii) the number of persons working in the population census tract, including the percentage of such persons who were not residents in the population census tract in the preceding year;

(iii) individual, family, and household poverty rates;

(iv) median family income of residents of the population census tract;

(v) demographic information on residents of the population census tract, including age, income, education, race, and employment;

(vi) the average percentage of income of residents of the population census tract spent on rent annually;

(vii) the number of residences in the population census tract;

(viii) the rate of home ownership in the population census tract;

(ix) the average value of residential property in the population census tract;

(x) the number of affordable housing units in the population census tract;

(xi) the number and percentage of residents in the population census tract that were not employed for the preceding year;

(xii) the number of new business starts in the population census tract; and

(xiii) the distribution of employees in the population census tract by NAICS Code.

The proposal requires the Secretary to establish appropriate procedures to ensure that any amounts reported do not disclose taxpayer return information that can be associated with any particular taxpayer or competitive or proprietary information, and if necessary to protect taxpayer return information, allows the Secretary to combine information required with respect to individual population census tracts into larger geographic areas.

Reporting of data on rural opportunity zone tax incentives

The proposal requires the Secretary to separately publish the same reports for qualified rural opportunity funds as those required above for qualified opportunity funds. For this purpose, the date of enactment of the proposal is substituted for the date of enactment of Public Law 115-97 (*i.e.*, December 22, 2017).

Effective Dates

The proposal establishing qualified rural opportunity zones applies to amounts invested after the date of enactment.

The proposal relating to information reporting requirements applies to calendar years beginning after the date of enactment.

The proposal relating to data to be reported by the Secretary becomes effective on the date of enactment.