



KPMG report: Treasury examines QOZ investments for reporting deficiencies

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The Treasury Inspector General for Tax Administration (TIGTA) on February 7, 2022, issued a final report assessing IRS implementation of the qualified opportunity zone (QOZ) program.¹

Although many of TIGTA's findings are redacted, the combined report and IRS response provide important information about the actions likely to be taken by the IRS to audit qualified opportunity funds (QOFs) and their investors.

The following discussion summarizes key unredacted findings from the report in order to highlight that QOFs and investors in QOFs may be scrutinized by the IRS.

Background

TIGTA was established in January 1999 to provide independent oversight of the IRS. TIGTA makes semiannual reports to Congress to highlight its various audits, investigations, and inspections and evaluations, many of which related to investigations into IRS employee misconduct.²

The release of the final TIGTA report on the QOZ program follows several other recent public critiques of the program—for example, in October 2021, the Government Accountability Office issued its second annual report on the QOZ program, providing updated statistics on QOZ investments and recommendations to the IRS on monitoring taxpayer compliance.³ Also in October 2021, David Wessel authored the book “Only the Rich Can Play” criticizing some of the deficiencies and weaknesses in the QOZ program. In November 2021, a congressional oversight subcommittee hearing on the QOZ program was held in which Mr. Wessel and other panelists provided testimonial statements on the QOZ program.⁴ Finally, on January 13, 2022, Senate Finance Committee Chair Ron Wyden announced an investigation into certain QOZ investments for potential exploitation of the program.⁵

The TIGTA review that is summarized in the final TIGTA report dates back at least to 2020, and therefore, does not appear to be directly related to recent press or Wyden's investigation into the QOZ program.

The TIGTA report summarizes results and recommendations from TIGTA's sample reviews of mainly 2019 tax year Forms 8996 and 8997 filed with the IRS.⁶ Some irregularities were identified in the forms reviewed and the report provided eight specific recommendations, of which six were adopted by the IRS. Below summarizes the additional actions recommended by the TIGTA report and certain key items from the IRS response to a draft of the TIGTA report, including the IRS's intended response to each of TIGTA's recommendations.

¹ TIGTA report number 2022-40-018, “Additional Actions Are Needed to Address Qualified Opportunity Zone Fund and Investor Noncompliance.” <https://www.treasury.gov/tigta/auditreports/2022reports/202240018fr.pdf>

² For example, the last semiannual report covering the period April 1, 2021 through September 30, 2021 summarized 52 audits, and 1,430 investigations.

³ <https://www.gao.gov/assets/gao-22-104019.pdf>

⁴ <https://waysandmeans.house.gov/legislation/hearings/oversight-subcommittee-hearing-opportunity-zone-program-and-who-it-left-behind>

⁵ <https://www.finance.senate.gov/chairmans-news/wyden-launches-investigation-into-opportunity-zones#:~:text=Washington%2C%20D.C.%20%E2%80%93%20Senate%20Finance%20Committee,for%20wealthy%20investors%20to%20avoid>. As a part of the investigation, Senator Wyden issued letters to seven taxpayers requesting specific information relevant to their QOZ investments.

⁶ The IRS response to the TIGTA report notes that the IRS has audited 100% of the Forms 8996 filed in 2018.

QOF reporting recommendations

The TIGTA report first focused on qualified opportunity funds (QOF) and concluded that additional actions are needed to address QOF noncompliance with the QOZ program requirements.

TIGTA reviewed 5,319 tax year 2019 e-filed Forms 8996 filed between January 1 and December 31, 2020 and concluded that the IRS did not have processes or procedures to fully identify and address QOFs that do not meet key program requirements, or that report potentially false information. Further, based on the review sample, TIGTA identified 341 (6.4%) QOFs reporting investments in another QOF, including 108 QOFs that reported an investment in itself.⁷ As a result, TIGTA made recommendations for the IRS to work with the IRS Office of Chief Counsel and Treasury to develop guidance for QOFs that intentionally do not comply with QOZ program requirements and procedures for QOF decertification for noncompliance.

The IRS agreed to work with the IRS Office of Chief Counsel to develop guidance addressing intentional noncompliance with the QOF program requirements. The IRS agreed with the recommendation to institute a compliance initiative project to review 2019 Forms 8996 to verify that taxpayers who self-certified as QOFs are meeting the statutory requirements of the program. The IRS, however, disagreed with the recommendation to develop currently procedures to decertify non-compliant QOFs. The IRS indicated that it cannot commit to developing processes and procedures to decertify until guidance is developed and issued regarding noncompliance.

Finally, the IRS agreed to audit certain QOFs that were identified in the TIGTA sample as being potentially non-compliant. Specifically, the IRS plans to develop and issue notices to (1) the 341 QOFs identified by TIGTA as either investing in another QOF, and in some cases, in themselves, and (2) the 699 QOFs that are identified as having either an invalid or incomplete filing on its 2019 tax year tax return.⁸

Investor reporting recommendations

The TIGTA report next focuses on investor reporting and concludes that additional actions are needed to identify and address inaccurate or incomplete investor reporting on Form 8997. During the review, TIGTA identified investors that either did not file or accurately file Form 8997. This form generally provides important information that allows the IRS to track an investor's deferred gain and the recognition of such gain upon a disposition of the equity interest in a QOF.

Upon an investor's disposition of its interest in a QOF, the QOF is generally required to report the disposition on both Form 8996 and Form 1099-B. TIGTA noted in its review that Form 8996 does not require the QOF to provide the tax identification number (TIN) of any investor that disposes of its interest in the QOF. The TIN is crucial in helping the IRS properly identify and examine the investor's proper reporting of the gain triggered upon such disposition. Interestingly, the IRS responded with the view that the request for a TIN would be duplicative as such information should already have been included in the

⁷ Section 1400Z-2(d)(1) of the Internal Revenue Code provides that a qualified opportunity fund is any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund).

⁸ This section of the report was heavily redacted, and it is not entirely clear what are the specific issues identified.

required Form 1099-B upon a disposition of a QOF interest. Further, the IRS contended that the investor's name would sufficiently support the verification of an investor's gain reporting requirements. However, based on TIGTA's sample review, verification by an investor's name is both inefficient and ineffective. As a result of TIGTA's recommendation, the IRS has updated the instructions for tax year 2021 Form 8996 to include a requirement that a QOF provide the TIN of an investor that disposes of its equity interests in the QOF.⁹

Finally, the IRS also agreed to develop and issue a notice to the 5,141 investors identified by TIGTA in the review sample as providing potentially incomplete or inaccurate information on the tax year 2019 Form 8997.

IRS internal tracking recommendations

TIGTA made other recommendations for additional actions needed to ensure (1) QOF compliance with reporting requirements¹⁰ (including processes and procedures to identify taxpayers that may have been erroneously flagged as a QOF in the IRS's database); and (2) proper transcribing of additional key data fields from paper-filed forms to identify QOF and investor noncompliance. The IRS rejected the allegation that it had erroneously marked certain taxpayers as QOFs in its database. However, the IRS updated its indicator codes to address TIGTA's concerns regarding potentially erroneous designations. The IRS also agreed to request the transcription of additional information from paper-filed returns prospectively.

IRS response

In addition to its responses to each of TIGTA's specific recommendations, the IRS further noted various actions it has already taken to help ensure compliance with QOZ program requirements, such as a 100% review of all 2018 QOZ related tax filings, QOZ soft letter and compliance projects, the development and delivery of training to examiners, and the development of technical resources for use by examiners. Noting that the TIGTA review had been ongoing since at least 2020, it may be the case that certain of the actions already taken by the IRS were in response to TIGTA's review.

KPMG observation

What do potentially affected taxpayers need to consider?

Both because of the information contained in the TIGTA report and IRS response—and also because COVID-19-related QOZ relief has now expired¹¹ leaving QOFs again subject to penalties for noncompliance with the 90% investment standard¹²—QOFs and their investors need to consider revisiting their qualification and compliance requirements to determine that they are, and

⁹ A specific field for the TIN, however, was not added to question 5 of the 2021 Form 8996. See, <https://www.irs.gov/pub/irs-pdf/i8996.pdf>.

¹⁰ For example, TIGTA identified that 555 of the 1,491 e-filed and paper-filed tax year 2018 Form 8996 were not again filed in the subsequent tax year, i.e., tax year 2019, as required.

¹¹ See Notices 2020-39 and 2021-10.

¹² See sections 1.1400Z-2(d)(1); (f)(1) of the Internal Revenue Code.

will be, satisfied. In many instances, it is expected that a QOF's ability to satisfy its testing requirements depends on the qualification of the underlying qualified opportunity zone business (QOZB) in which the QOF has invested. As such, proper implementation of a "Working Capital Safe Harbor" plan at the QOZB level continues to be one of the most important factors in the success and qualification of a QOF.¹³ Taxpayers may need to consult and work with their tax advisors to put in place process and procedures to maintain QOF and QOZB compliance and qualification.

For more information, contact a member of KPMG's Qualified Opportunity Zone Leadership Team or visit KPMG LLP's [Opportunity Zones website](#).

¹³ See Treas. Reg. section 1.1400Z2(d)-1(d)(3)(v).

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