Strafford

Presenting a live 90-minute webinar with interactive Q&A

Avoiding Disguised Sales in Qualified Opportunity Funds: Critical Tax Considerations for QOF Investments

Recent IRS Regulations, Application of Section 707, Exceptions, Assumption of Liabilities, Debt Financed Transfer Considerations

THURSDAY, JANUARY 30, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Gene Crick, Jr., Partner, **Nelson Mullins Riley & Scarborough**, Orlando, Fla.

Derek Kershaw, Counsel, **Shearman & Sterling**, New York

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1.**

NOTE: If you are seeking CPE credit, you must listen via your computer — phone listening is no longer permitted.

NELSON MULLINS
BROAD AND CASSEL

MEMORANDUM

To: Stafford Webinar

From: Gene E. Crick, Jr,

Date: January 20, 2020

Re: Disguised Sales in Qualified Opportunity Zones

Outline

O-Zone Treasury Regulations

The Preamble to the final QOZ Treasury Regulations state that the existing analytical framework for Treas. Reg. Secs. 1.1400Z-2(a)-1(c)(6)(iii)(A)(1) and (2) are Section 707 and the Treasury Regulations thereunder. The final QOZ regulations adopt the Section 707 Treasury Regulations, including the exceptions, without change. The rules dealing with noncash property contributed by a partner to a QOF partnership and noncash property distributed by a QOF partnership to a partner in the Section 707 Treasury Regulations determine to what extent a disguised sale of property occurs, and then the QOZ regulations under Treas. Reg. Sec. 1.1400Z-2(a)-1(c)(6)(iii)(A)(1) establish that the contribution of property representing a capital gain for an equity interest in the QOF partnership is disallowed as a eligible gain and the interest received is not an eligible interest in the QOF partnership. Further, in the event a contribution of cash is made by a taxpayer to a QOF partnership for an equity interest and a partnership distribution of cash is made to the partner, the above rule does not recharacterize these transactions, but Treas. Reg, Sec 1.1400Z-2(a)-1(c)(6)(iii)(A)(2) will apply to the extent the contribution and distribution would be viewed together as a disguised sale if the contribution were treated as a contribution of noncash property and any debt financed distribution under Treas. Reg. Sec. 1.707-5(b) were treated so the allocable share of liabilities of a partner is zero. This as if rule will reduce the eligible investment of the contributing partner by the amount of the distribution, instead of the rule above describing disguised sales that will disallow the contribution by the contributing partner for all purposes as an eligible investment.

Disguised Sale Regulations

The Treasury Regulations discussed below apply to contributions and distributions of property described in Sections 707(a)(2)(A) and 707(a)(2)(B) of the Internal Revenue Code.

Treas. Reg. Sec. 1.707-3 addresses a transfer of noncash property by a partner to a partnership and one or more transfers of cash or other consideration by the partnership to that partner and treats these transfers as a sale of property, in whole or in part, to the partnership. Any transfer

that is treated as a sale is treated as a sale for all purposes of the Code. The sale is considered to take place on the date that the partnership is considered the owner of the property for federal income tax purposes. If there is a delay between the contribution and distribution, the partnership is treated as if, on the date of the sale, the partnership transferred to the partner an obligation to transfer to the partner cash or other consideration.

A transfer of noncash property by a partner to a partnership and a transfer of cash of other consideration (including the assumption of or the taking subject to a liability) by the partnership to the partner constitute a sale of property, in whole or in part by the partner to the partnership only if based on all facts and circumstances –

(i) The transfer of cash or other consideration would not have been made but for the transfer of property; and
(ii) In cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

The weight to be given each of the facts and circumstances will depend on the particular case. Generally, the facts and circumstances existing on the date of the earliest of such transfers are the ones considered in determining whether a sale exists. The facts and circumstances that may tend to prove the existence of a sale are as follows:

(i) That the timing and the amount of a subsequent transfer are determinable with reasonable certainty at the time of the earlier transfer;
(ii) That the transferor has a legally enforceable right to the subsequent transfer;
(iii) That the partner's right to receive the transfer of cash or other consideration is secured in any manner, taking into account the period during which it is secured;
(iv) That any person has made or is legally obligated to make contributions to the partnership in order to permit the partnership to make the transfer of cash or other consideration;
(v) That any person has loaned or has agreed to loan the partnership the cash or other consideration required to enable the partnership to make the transfer, taking into account whether any such lending obligation is subject to contingences related to the results of partnership operations;
(vi) That the partnership has incurred or is obligated to incur debt to acquire the cash or other consideration necessary to permit it to make the transfer, considering the likelihood that the partnership will be able to incur the debt (considering such factors as whether any person has agreed to guarantee or otherwise assume personal liability for the debt)
(vii) That the partnership holds cash or other liquid assets beyond the reasonable needs of the business, that are expected to be available to make the transfer (taking into account the income that will be earned from those assets);
(viii) That partnership distributions, allocations or control of partnership operations is designed to effect an exchange of the burdens and benefits of ownership of the property;

(ix) That the transfer of cash or other consideration by the partnership to the partner is disproportionately large in relationship to the partner's general and continuing interest in the partnership's profits; and

(x) That the partner has no obligation to return or repay the cash or other consideration to the partnership or has such an obligation but it is likely to become due at such distant point in the future that the present value of that obligation is small in relation to the amount of cash or other consideration transferred by the partnership to the partner.

For purposes of this section, if within a two year period, a partner transfers noncash property to a partnership and the partnership transfers cash or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale. Disclosure to the IRS is required in accordance with Treas. Reg. Sec. 1.707-8 if within a two year period, a partner contributes noncash property to a partnership and the partnership transfers cash or other consideration to that partner and the partner treats the transfers other than a sale for tax purposes and the transfer of cash is not presumed to be a guaranteed payment for capital, reasonable preferred return or operating cash flow distribution under Treas. Reg. Sec. 1.707-4.

For purposes of this section, transfers of cash or other consideration to a partner by a partnership and the transfer of noncash property to the partnership by the partner are more than two years apart, the transfers are presumed not to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers constitute a sale.

Treas. Reg. Sec. 1.707-4.

Notwithstanding the disguised sale presumption for transfers within two years, both guaranteed payments for capital and preferred returns are presumed not to be part of a sale of property unless the facts and circumstances clearly establish that the transfer is part of a sale, if they are reasonable in amount and are made pursuant to a written provision of a partnership agreement that provides for payment for the use of capital in a reasonable amount and only to the extent that the payment is made for the use of capital after the date on which that provision is added to the partnership agreement. A guaranteed payment for capital is defined as any payment to a partner that is determined without regard to partnership taxable income and is for the use of that partner's capital as provided in Section 707(c). A preferred return is a preferential distribution of partnership cash flow to a partner with respect to capital contributed to the partnership by the partner that will be matched by an allocation of income or gain, if available. A payment is regarded as reasonable if the sum of any guaranteed payment or preferred return for that year is determined by multiplying (A) the partner's unreturned capital at the beginning of the year or the partner's weighted average capital balance for the year (with either amount adjusted for compounding periods to account for unpaid amounts) by (B) the safe harbor interest rate for that year. This safe harbor interest rate for a year is 150% of the highest applicable Federal rate under Section 1274, at the appropriate compounding period in effect at the time the right to the guaranteed payment or preferred return is first established pursuant to a binding written agreement among the partners through the end of the taxable year. A partner's unreturned capital

equals the excess of the aggregate amount of cash and the fair market value of other consideration (net of liabilities) contributed by the partner to the partnership over the aggregate amount of cash and the fair market value of other consideration (net of liabilities) distributed by the partnership to the partner, other than transfers of cash that are presumed to be guaranteed payments for capital, reasonable preferred returns and operating cash flow distributions, all as described under this regulation.

Notwithstanding the disguised sale presumption for transfers within two years, an operating cash flow distribution is presumed not to be a part of a sale of property unless the facts and circumstances clearly establish that the transfer is part of a sale. An operating cash flow distribution is defined as one or more transfers of cash by the partnership to the partner during the taxable year as long as the distributions are not presumed to be guaranteed payments for capital or reasonable preferred returns and are not characterized by the partners as distributions to the partner acting in a capacity other than as a partner and do not exceed the product of the net cash flow of the partnership from operations for the year multiplied by the lesser of the partner's percentage interest in overall partnership profits for that year or the partner's percentage interest in overall profits for the life of the partnership. The net cash flow of the partnership from operations for a taxable year is an amount equal to the taxable income or loss of the partnership's business and investment activities, increased by tax exempt interest, cost recovery allowances and other noncash charges deducted in determining such taxable income and decreased by (i) principal payments made on any partnership liabilities; (ii) partnership replacement or contingency reserves actually established by the partnership; (iii) capital expenditures when made other than from reserves or from borrowings the proceeds of which are not included in operating cash flow; and (iv) any other cash expenditure (including preferred returns) not deducted in determining such taxable income or loss.

Notwithstanding the disguised sale presumption for transfers within two years, a transfer of cash or other consideration by the partnership to a partner is presumed not to be a part of a sale of property to the extent that the transfer to the partner by the partnership is made to reimburse the partner for, and does not exceed, the amount of capital expenditures that are (a) are incurred during the two year period preceding the transfer by the partner to the partnership and (b) are incurred by the partner for (i) partnership organization and syndication costs described in Section 709; (ii) property transferred to the partnership by the partner, but only to the extent the reimbursed capital expenditures do not exceed 20% of the fair market value of such property at the time of the transfer (the 20% limitation). However, the 20% limitation does not apply if the fair market value of the transferred property does not exceed 120 percent of the partner's adjusted basis in the transferred property at the time of transfer (the 120 percent test). This paragraph shall be applied on a property-by-property basis, except that a partner may aggregate any of the transferred property under this paragraph to the extent: (1) The total fair market value of such aggregated property (of which no single property's fair market value exceeds 1 percent of the total fair market value of such aggregated property) is not greater than the lesser of 10 percent of the total fair market value of all property, excluding cash and marketable securities (as defined under Section 731(c)), transferred by the partner to the partnership, or $1,000,000;
(2) The partner uses a reasonable aggregation method that is consistently applied; and
(3) Such aggregation of property is not part of a plan a principal purpose of which is to avoid Treas. Reg. Sec. 1.707-3 through 1.707-5. The regulations provide for a step in shoes rule for

capital expenditures incurred by another person if not previously reimbursed to this person as long as the incoming partner acquired the property from such person in a nonrecognition transaction described in Sections 351,381(a),721 or 731 and contributed the property to the partnership. Another rule in the regulations applies this step in shoes concept in a case where a person transfers property for which this person incurred capital expenditures to a partnership (lower tier partnership) in return for a partnership interest in this partnership and within two years from the date of incurring the expenditures, the person transfers the partnership interest of this lower tier partnership to another partnership (the upper tier partnership) in a nonrecognition transaction under Section 721, holding that the upper tier partnership steps in the shoes of the person who transfers the property to the lower tier partnership that are not otherwise reimbursed to the person.

Capital expenditures are treated as funded by the proceeds of a qualified liability to the extent the proceeds are either traceable to the capital expenditures under Treas. Reg. Sec. 1.163-8T or were actually used to fund the capital expenditures, without regard to the tracing requirement of Treas. Reg. Sec. 1.163-8T. For purposes of the above paragraph, if capital expenditures were funded by the proceeds of a qualified liability (defined in Treas. Reg. Sec. 1.707-5(a)(6)(i)) that a partnership assumes or takes property subject to in connection with a transfer of property to the partnership by a partner, a transfer of cash or other consideration by the partnership to the partner is not treated as made to reimburse the partner for such capital expenditure to the extent the transfer of cash or other consideration by the partnership to the partner exceeds the partner's share of the qualified liability (as determined under Treas. Reg. Sec. 1.707-5(a)(2), (3) and (4)). For these purposes, capital expenditures have the same meaning as the term capital expenditures has under the Code and applicable regulations, except it includes capital expenditures taxpayer's elect to deduct, but does not include deductible expenses taxpayers elect to treat as capital expenditures.

Treas. Reg. Sec. 1.707-5.

For purposes of this section and sections 1.707-3 and 1.707-4, if a partnership assumes or takes subject to a qualified liability of a partner in connection with the partner contributing property to the partnership and this transaction is not treated as a disguised sale, the partnership is not treated as transferring consideration to the partner as part of a sale if the total amount of all liabilities other than qualified liabilities that the partnership assumes or takes subject to is the lesser of 10 percent of the total amount of all qualified liabilities, the partnership assumes or takes subject to, or $1,000,000. If the transfer of property by a partner to a partnership is treated as a disguised sale without regard to the partnership's assumption of or taking subject to qualified liability, the partnership's assumption of or taking subject to that liability is treated as a transfer of consideration made pursuant to the sale of such property to the partnership only to the extent of the lesser of (A) the amount of consideration that the partnership would be treated as transferring to the partner under the paragraph if the liability were not a qualified liability or (B) the amount obtained by multiplying the amount of the qualified liability by the partner's net equity percentage for that property. The partner's net equity percentage for an item of property equals the percentage determined by dividing (1) The aggregate transfers of cash or other consideration to the partner that are treated as proceeds realized from the sale of the transferred property; by (2) the excess of fair market value of the property at the time it is transferred to the

partnership over any qualified liability encumbering the property or properly allocated to the property.

For purposes of this section and sections 1.707-3 and 1.707-4, if the partnership assumes or takes subject to a liability of the partner other than a qualified liability in connection with the partner contributing property to the partnership, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of the liabilities immediately after the partnership assumes or takes subject to the liability. A partner's share of any liability is determined as follows: (i) for recourse liabilities, a partner's share equals the partner's share of the liability under the rules of Section 752 and the regulations in this part under Section 752. A partnership liability is a recourse liability to the extent provided under Treas. Reg. Sec. 1.752-1(a)(1) or would be treated as a recourse liability of the partnership under that section if it were treated as a partnership liability for purposes of that section; and (ii) for nonrecourse liabilities, a partner's share is determined by applying the partner's share of excess nonrecourse liability under Treas. Reg. Sec. 1.752-3(a)(3). A partnership liability is a nonrecourse liability to the extent provided under Treas. Reg. Sec. 1.752-1(a)(2) or would be a nonrecourse liability of the partnership under Treas. Reg. Sec. 1.752-1(a)(2) if it were treated as partnership liability for purposes of that section.

For purposes of this section, a partner's share of a liability, immediately after a partnership assumes or takes property subject to the liability, is determined by taking into account a subsequent reduction in the partner's share if: (i) at the time the partnership assumes or takes property subject to the liability, it is anticipated that the transferring partner's share of the liability will be subsequently reduced; (ii) the anticipated reduction is not subject to entrepreneurial risk of partnership operations; and (iii) the reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the assumption of or the taking property subject to the liability is treated as part of a sale under Treas. Reg. Sec. 1.707-3.

A liability assumed or taken subject to by a partnership in connection with a transfer of property to the partnership by a partner is a qualified liability only to the extent:

(i) the liability is:

(A) A liability that was incurred by the partner more than two years prior to the earlier of the date the partner agrees in writing to transfer the property to the partnership and that encumbered the transferred property throughout that two-year period;
(B) A liability that was not incurred in anticipation of the transfer of the property to a partnership, but was incurred by the partner within the two-year period prior to the earlier of the date the partner agrees in writing to transfer the property or the date the partner transfers the property to the partnership and that has encumbered the transferred property since it was incurred (See the first paragraph after (ii) below);
(C) A liability that is allocable under the rules of Treas. Reg. Sec. 1.163-8T to capital expenditures within the meaning of section 1.707-4(d)(5);
(D) A liability that was incurred in the ordinary course of the trade or business in which the property transferred to the partnership was used or held but only if all assets related to

that trade or business are transferred other than assets that are not material to a continuation of the trade or business; or

(E) A liability that was not incurred in anticipation of the transfer of the property to a partnership, but was incurred in connection with a trade or business in which property transferred to the partnership was used or held but only if all assets related to the trade or business are transferred other than assets that are not material to a continuation of the trade or business (See the first paragraph after (ii) below); and

(ii) If the liability is a recourse liability, the amount of the liability does not exceed the fair market value of the transferred property (less the amount of other liabilities that are senior in priority and that either encumber such property or are liabilities described in paragraphs (C) or (D) above) at the time of the transfer.

For purposes of this section, if within a two-year period, a partner incurs a liability (other than a liability described in paragraphs (C) or (D) above) and transfers property to a partnership or agrees in writing to transfer the property, and in connection with the transfer, the partnership assumes or takes the property subject to the liability, the liability is presumed to be in anticipation of the transfer unless the facts and circumstances clearly establish that the liability was not incurred in anticipation of the transfer.

A partner that treats a liability assumed or taken subject to by a partnership in connection with a transfer of property as a qualified liability described in paragraphs (B) or (E) must disclose such treatment to the IRS in accordance with Treas. Reg. Sec. 1.707-8.

The regulations provide for a step in shoes rule for a liability assumed or taken subject to by another person as long as the incoming partner assumed or took property subject to the liability from this person in a nonrecognition transaction described in Sections 351,381(a),721 or 731 and contributed the property to the partnership. Another rule in the regulations applies this step in shoes concept if an interest in a partnership that has one or more liabilities (lower tier partnership) is transferred to another partnership (the upper tier partnership), the upper tier partnership's share of any liability of the lower tier partnership that is treated as a liability of the upper tier partnership under Treas. Reg. Sec. 1.752-4(a) is treated as a qualified liability under this section to the extent the liability would be a qualified liability had the liability been assumed or taken subject to by the upper tier partnership in connection with a transfer of all of the lower tier partnership's property to the upper tier partnership by the lower tier partnership.

For purposes of Treas. Reg. Sec. 1.707-3, if a partner transfers property to a partnership, and the partnership incurs a liability and all or a portion of the proceeds of that liability are allocable under Treas. Reg. Sec. 1.163-8T to a transfer of cash or other consideration to the partner made within 90 days of incurring the liability, the transfer of cash or other consideration to the partner is taken into account only to the extent that the amount of cash or the fair market value of the other consideration transferred exceeds the partner's allocable share of the partnership liability. For this purpose, an upper tier partnership's share of the liability under Treas. Reg. Sec. 1.707-5(a)(2) that is treated as a liability of the upper tier partnership under Treas. Reg. Sec. 1.752-4(a) shall be treated as a liability of the upper tier partnership incurred on the same day the liability was incurred by the lower tier partnership. A partner's allocable share

of a partnership liability for purposes of this paragraph equals the amount obtained by multiplying the partner's share of the liability as described in Treas. Reg. Sec. 1.707-5(a)(2) by a fraction determined by dividing (A) the portion of the liability that is allocable under Treas. Reg. Sec. 1.163-8T to the cash or other consideration transferred to the partner; by (B) the total amount of the liability.

Treas. Reg. Sec. 1.707-6.

Rules similar to those provided in Treas. Reg. Sec. 1.707-3 apply in determining whether a transfer of property by a partnership to a partner and one or more transfers of cash or other consideration by that partner to the partnership are treated as a sale of property, in whole or in part, to the partner.

Rules similar to those provide in Treas. Reg. Sec. 1.707-5 apply to determine the extent to which an assumption of or taking subject to a liability by a partner, in connection with a transfer of property by a partnership, is considered part of a sale. Accordingly, if a partner assumes or takes property subject to a qualified liability of a partnership and the transfer by the partnership of the property to the partner is not otherwise treated as a sale, the partner is not treated as transferring consideration to the partnership as part of the sale.

However, if a transfer of property by the partnership to the partner is treated as part of a sale without regard to the partner's assumption or taking subject to a qualified liability, the partner's assumption of or taking subject to that liability is treated as a transfer of consideration to the partnership as part of a sale of the property to the partner to the extent of the lesser of: (A) the amount of consideration that the partner would be treated as transferring to the partnership is the amount that the liability assumed or taken subject to by the partner exceeds the partner's share of that liability (pursuant to Treas. Reg. Sec. 1.752-1(a) depending on whether the liability is recourse or nonrecourse), immediately before the transfer; or (B) the amount obtained by multiplying the amount of the liability at the time of its assumption or taking subject to by the partnership's net equity percentage with respect to that property. A partner's net equity percentage with respect to an item of property encumbered by a qualified liability equals the percentage determined by dividing: (A) the aggregate transfers to the partnership by the partner that are treated as the proceeds realized from the sale of the transferred property to the partner (other than the transfers to the partnership described in the first (A) of this paragraph); by (B) The excess of the fair market value of the property at the time it is transferred to the partner over any qualified liabilities of the partnership that are assumed or taken subject to by the partner at that time. This section modifies the definition of qualified liability contained in Treas. Reg. Sec. 1.707-5(a)(6) as follows: (i) In applying the definition, a qualified liability is one that is originally an obligation of the partnership and is assumed or taken subject to by the partner in connection with the a transfer of property to the partner; (ii) If the liability was incurred by the partnership more than two years prior to the earlier of the date the partnership agrees in writing to transfer the property or the date the partnership transfers the property to the partner, that liability is a qualified liability whether or not it has encumbered the transferred property throughout the two-year period.

A partnership is required to disclose to the IRS, in accordance with Treas. Reg. Sec. 1.707-8, facts and circumstances of a transfer as follows: (1) When a partnership transfers property to a partner and the partner transfers cash or other consideration to the partnership within a two-year period (without regard to the order of the transfers) and the partnership treats the transfer as other than a sale for tax purposes; and (2) when a partner assumes or takes subject to a liability of a partnership in connection with a transfer of property by the partnership to the partner, and the partnership incurred the liability within the two-year period prior to the earlier of the date the partnership agrees in writing to the transfer of property or the date the partnership transfers the property and the partnership treats the liability as a qualified liability because the liability was not incurred in anticipation of the transfer of the property to the partner and has encumbered the transferred property since it has incurred (See Treas. Reg. Sec. 1.707-5(a)(7)).

Former Treas. Reg. Sec. 1.707-7.

Applying the above regulations, within a two-year period, if a partner ("purchasing partner") transfers cash, noncash property or other consideration to a partnership in return for a partnership interest and the partnership transfers such consideration transferred by the purchasing partner to another partner ("the selling partner") to redeem such partner's partnership interest, these transfers may be treated, in whole or in part, as a sale of the selling partner's partnership interest to the purchasing partner.

Even though Proposed Treas. Reg. Section 1.707-7 and the Notice of Proposed Rulemaking (Reg 149519-03) were withdrawn by publication in the Federal Register on November 26, 2004 (69 FR 68838), the IRS may still apply concepts in Treas. Reg. Secs. 1.707-3 through 1.707-6 to characterize transfers in connection with partnership interests as disguised sales.

NELSON MULLINS
BROAD AND CASSEL

MEMORANDUM

To: [Client Name]

From: Gene E. Crick, Jr,

Date: January 24,2020

Re: Examples of Treas. Regulations dealing with Disguised Sales at the QOF Partnership level

---

1. A QOF partnership receives a contribution of $10,000 in cash from Fred in return for a 10% interest in the partnership on March 1, 2019, and the QOF partnership makes a distribution of $5,000 in cash to Fred on October 20, 2020.

   Treas. Reg. Sec. 1.1400Z-2(a)-1(c)(6)(iii)(A)(2) will treat the cash contributed by Fred to the QOF partnership as noncash property so that the distribution of cash within a two-year period is treated as part of a disguised sale of property by Fred to the QOF partnership within the meaning of Treas. Reg. Sec. 1.707-3, which reduces the qualifying investment of Fred by 50%, leaving Fred with a 5% interest in the QOF with a reduced qualified investment of $5,000.

2. Sarah contributed $1,000,000 in cash to a QOF partnership for a 30% interest in the partnership on October 15, 2018, Barney contributes land to a QOF partnership with a $1,000,000 value and a $500,000 basis for a 30% interest in the partnership on February 15, 2019, on September 30, 2019, the QOF partnership distributes the land to Sarah in complete redemption of her interest in the QOF partnership and the QOF partnership distributes $1,000,000 in cash to Barney on April 15 2020.

   Treas. Reg. Sec. 1.1400Z-2(a)-1(c)(6)(iii)(A)(1) and Treas. Reg. Sec. 1.707-3 would entirely disallow the contribution of $500,000 by Barney as a qualifying investment in QOF partnership because the earlier contribution of the cash by Sarah and the later distribution of the cash to Barney constitutes a disguised sale of the land contributed by Barney to the QOF partnership and later distributed to Sarah. Sarah would have an inclusion event resulting from the redemption under Section 736(b), reducing all of her qualified investment in the QOF partnership. Sarah may invest this inclusion amount into a QOF and elect to defer tax on the gain and receive a new qualifying investment in a QOF.

3. QOF Partnership started as a QOF in July 2018 and completed receiving investor contributions in September 2018. The QOZB partnership in which the QOF partnership invested started its trade or business and refinanced its debt in January 2020. In February 2020, the QOZB partnership distributed the proceeds to the QOF Partnership and QOF

partnership distributed the proceeds to its members in an amount equal to 20% of their qualifying interests.

Under Treas. Reg. Sec. 1.1400Z-2(a)-1(c)(6)(iii)(A)(2), each partner of the QOF partnership would have a reduction in their qualifying investment equal to 20% because for purposes of Treas. Reg. Sec. 1.707-5(b), the members are treated as not receive a share of the debt allocated.

4. A QOF began operation in 2018 and invested in a QOZB partnership in 2018. In 2020, Susan owns land valued at $1,000,000 which has a basis of $500,000, and Susan obtains a $300,0000 nonrecourse loan from a bank and encumbers the land with a mortgage in favor of the bank. Later in 2020, Susan contributes the land to the QOF Partnership for an interest equal to 20% for his net contribution of $700,000.

   Assuming Susan's interest in excess nonrecourse liabilities is 20%, Susan's qualifying investment is $500,000 and she has a mixed investment for $500,000. Since the debt was incurred near in the time to her contribution, the QOF partnership is treated as transferring consideration to Susan to the extent the nonrecourse liability of $300,000 exceeds Susan's share of the liability of $60,000 (20% multiplied by $300,000) or $240,000. Therefore, the gain recognized by Susan is $120,000 ($240,000/$1,000,000 multiplied by $500,000) and is equal to the amount of the disguised sale of her qualifying investment and that portion of her qualifying investment is disallowed, making here restated qualified investment equal $380,000.