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## IRS Releases Revenue Ruling Clarifying “Original Use” and “Substantial Improvement” Requirements for Qualified Opportunity Zone Property

The IRS released Revenue Ruling 2018-29, 2018-45 IRB (<https://www.irs.gov/pub/irs-drop/rr-18-29.pdf>), which should be particularly interesting for real estate developers and investors, since it provides guidance on the “original use” and “substantial improvement” requirements for property purchased by a qualified opportunity fund (QOF) in a qualified opportunity zone (QOZ). Although the QOZ statute does not expressly address the application of the substantial improvement requirement to land, the proposed regulations (see our prior coverage here (<https://www.stradley.com/insights/publications/2018/10/tax-insights-october-24-2018>)), as elaborated on in Revenue Ruling 2018-29, provide that the substantial improvement requirement does not apply to land. The substantial improvement requirement applies to tangible property, other than land, that was used in a QOZ prior to its acquisition by the QOF. To constitute a substantial improvement, the QOF must invest more in the tangible property, during any 30-month period, than the adjusted basis in the property at the beginning of such period.

Revenue Ruling 2018-29 describes a taxpayer that purchased a factory and the land on which it was situated (both within a QOZ) with the intent to convert the building into residential real property. Revenue Ruling 2018-29 notes that the original use of land can never be considered to have commenced with a QOF. The Revenue Ruling concludes that (i) the requirement that the original use of property commence with a QOF is not applicable to the land on which the building is located, (ii) the QOF’s satisfaction of the “substantial improvement” requirement is measured by the QOF’s additions to the adjusted basis of the building and (iii) the QOF is not required to separately improve the land.

Although the substantial improvement may be applied over “any” 30-month period, neither the proposed regulations nor Revenue Ruling 2018-29 clarify how long the QOF can wait to apply the substantial improvement requirement. The taxpayer described in the example set forth in Revenue Ruling meets the requirement in the first 30-month period, but is silent as to how long that could have been deferred. Also, the example in the Revenue Ruling uses a capital expenditure of 25 percent more than the acquisition cost of the existing asset. However, it is important to note that is simply an example and not a rule.

## IRS Releases FAQs on Tax Benefits in QOZ and Qualifying for QOF Status

The IRS recently posted frequently asked questions (<https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>) on its website providing details on QOZs and how to set up a QOF.

## NYSBA Issues Recommendations for Proposed Section 199A Regs

The New York State Bar Association Tax Section has submitted a report ([http://www.nysba.org/Sections/Tax/Tax\\_Section\\_Reports/Tax\\_Reports\\_2018/1403\\_Report.html](http://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2018/1403_Report.html)) on proposed Section 199A regulations, addressing issues generally applicable to taxpayers whose income exceeds the threshold amount defined in Section 199A(e)(2). (Section references are to the Internal Revenue Code of 1986, as amended.) (For a prior New York State Bar Association Tax Section report on qualified business income, see our prior coverage here (<https://>

[www.stradley.com/insights/publications/2018/04/tax-insights-april-4-2018](http://www.stradley.com/insights/publications/2018/04/tax-insights-april-4-2018).)

### NYSBA Tax Section Issues Report on Dividends Received Deduction

The New York State Bar Association Tax Section also has submitted a report ([https://www.nysba.org/Sections/Tax/Tax\\_Section\\_Reports/Tax\\_Reports\\_2018/1404\\_Report.html](https://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2018/1404_Report.html)) on the Section 245A dividends received deduction for dividends distributed by a controlled foreign corporation. Section 245A was added to the Internal Revenue Code under the Tax Cuts and Jobs Act as part of the U.S.'s move toward a modified territorial tax system for income earned by foreign subsidiaries of domestic corporations and other domestic shareholders. Section 245A provides for a 100 percent dividends received deduction regarding the "foreign-source portion" of any dividend received from a specified 10 percent-owned foreign corporation by a domestic corporation that is a U.S. shareholder.

### IRPAC Releases 2018 Report

The IRS Information Reporting Program Advisory Committee (IRPAC) has released its annual report (Publication 5315 (<https://www.irs.gov/pub/irs-pdf/p5315.pdf>)), which contains its recommendations on such tax administration issues as change of business master file entity addresses, e-signature for Form W-9, the Tax Cuts and Jobs Act (P.L. 115-97), practitioner identification and identity theft, and cryptocurrency.

### Pennsylvania Supreme Court Holds Intellectual Property Not Subject to Sales Tax

The Pennsylvania Supreme Court recently decided *Downs Racing LP v. Commonwealth of Pennsylvania* (<http://www.pacourts.us/assets/opinions/Supreme/out/j->

[109a\\_b-2018mo.pdf#search=%22Downs%20Racing%20%27Supreme%2bCourt%27%22](#)), in which it held that intellectual property is not tangible personal property. The decision reverses the Commonwealth Court's holding that royalty payments for intellectual property associated with video poker machines are subject to sales and use tax. The decision upholds, however, a sales and use tax assessment on services performed to simulcast the casino's horse races under a contract with Teleview Racing Patrol Inc. because the nontaxable services were not separately stated on the invoices.



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