Married with Children? How about Married with Capital Gains!

The OZ world is full of complicated rules, but one of the simplest and most basic principles is that the taxpayer who recognizes eligible gain from a sale of property to an unrelated person is the party that can (and must) invest that gain into a QOF within the applicable 180-day period.

But what happens when the property being sold is owned by a married couple – whether in a brokerage account as tenants in common with rights of survivorship, or in real estate owned as tenants by the entirely, or any other "joint" ownership between the spouses?

The black letter tax law is clear on one issue: If spouses sell jointly owned property and then file separate federal income tax returns, each spouse reports 50% of the gain separately. On a joint return nobody sweats the nuances because it all ends up in the same place. But given the technical requirements of the OZ Act, can one of the two spouses reinvest ALL the gain into a QOF, or does each spouse need to timely reinvest 50% the gain in the applicable 180-day period?

This issue arose recently, and it clearly needs to be handled properly. The taxpayers' accountant (a very good tax accountant but by his own admission unfamiliar with the OZ Act) initially told the married couple that since the gain all showed up on the same tax return it should not make any difference who reinvested the gain.

But the OZ Act, and especially the Final Regulations, tend to be very sedulous and pedantic about technical issues – including the treatment of transactions between spouses.

When the Final Regulations were issued and later published in the Federal Register on January 13, 2020, most knowing tax advisors– including this Website – were astonished that the IRS completely overrode Code Section 1041 and concluded that a transfer of a QOF interest from one spouse to the other spouse was an "inclusion event" triggering full recognition of the deferred gain invested in the applicable QOF. Note that transfers of property between spouses are ALWAYS protected from recognition of income or gain for federal income tax purposes – except when a QOF is being transferred.

Given that the Final Regulations do not allow a transfer of gain AFTER it is invested in a QOF, it seems all too likely that the Treasury and IRS would likely look askance at a transfer of gain BEFORE it is invested in a QOF. Just saying.

So in that situation we recommended – strongly – that each spouse invest 50% of the gain amount into the applicable QOF. That is the ONE alternative that is clearly NOT WRONG. Everything else?

Well, we don't know the answer to that question – and there is no reason to find out. The famous line from Charlie McCarthy was, "Hard work never killed anyone, but why take a chance?"

The same logic applies in this situation: Why take a chance, indeed?