November 14, 2018

The Tax Cuts & Jobs Act Qualified Opportunity Zones

The 2017 Tax Cuts and Jobs Act provides a significant opportunity to defer and partially eliminate federal income taxes on capital gains through the use of Qualified Opportunity Funds ("QOF"). A general overview of the mechanics of a QOF is as follows:

- A QOF is an investment vehicle that is set up as a corporation or partnership and is to be used to invest in real estate or business interests in Qualified Opportunity Zones (QOZ). QOZ's have been named by the U.S. Treasury in economically distressed areas throughout the United States.

- A capital gain can be deferred if, within 180 days after the sale, the gain is reinvested in a QOF. Note that the federal income tax on the gain is not due until December 31, 2026 or, if earlier, the date you sell your investment in the QOF. Also note that only the amount of the gain needs to be reinvested in a QOF in order to defer federal taxation, not the entire sales proceeds. (Contrast this with the provisions in a like-kind exchange where the entire sales proceeds need to be reinvested in order to defer 100% of the taxable gain.)

- If an interest in a QOF is held for five years prior to December 31, 2026, 10% of the original gain is eliminated. If the investment is held for at least seven years prior to December 31, 2026, an additional 5% of the taxable gain is eliminated. As a result of these provisions, a QOF investment made in 2018 or 2019 and which is still held as of December 31, 2026, results in a 15% exclusion of the original gain when subject to tax in 2026.

- In addition, any appreciation of the investment in the QOF will not be subject to federal income tax if the QOF investment is held for at least ten years.

- An investment in a QOF can be made as a passive partner or shareholder in a fund that is organized and managed by a third party. Pre-selected locations across the country, including those in the Lehigh Valley and its 3 largest cities, qualify as QOF's. Some of the major brokerage firms are reviewing the QOF provisions at this time and considering establishing QOF's. Conversely, you can form your own fund and manage the fund's business or real estate. Funds must generally be used to purchase or develop new property or substantially improve existing property.

Investments in QOF's may be able to provide significant tax benefits by shielding capital gains from Federal income tax. The recently-issued regulations are lengthy and we would be happy to meet with you to discuss the benefits of the newly created Qualified Opportunity Fund provisions with you.

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