September 6, 2018

Qualified Opportunity Funds

Embedded into the recently enacted Tax Cuts and Jobs Act of 2017 is Internal Revenue Code Section 1400Z a/k/a the "Opportunity Zone Program" (hereinafter "OZP"). Although the Internal Revenue Service has thus far failed to address some aspects of the OZP we do have sufficient information to move forward with a view toward tax planning. The OZP is yet another arrow to the tax lawyer's quiver.

Tax Benefits

- Deferral of otherwise taxable capital gains.
- Potential permanent exclusion of 15% of taxable capital gains.
- Potential permanent exclusion of Investments in Qualified Opportunity Funds.

How It Works

Taxpayer realizes a gain from the sale of property (real or personal) and re-invests the gain (not the full proceeds) into a "Qualified Opportunity Fund" (hereinafter "QOF") such gain is deferred until the earlier of December 31, 2026 *or* the date when the amount invested in the QOF is sold. Moreover, if the investment is held for five (5) years the gain is reduced by ten (10%) percent and by fifteen (15%) percent if held for seven (7) years. The Taxpayer has 180 days from the date of the sale to re-invest the gain in the QOF. This 180-day requirement is also found in Like-Kind Exchanges per IRC Sec. 1031. If the QOF is held for ten (10) years or more, the appreciation in the QOF is excluded from income taxes.

> **EXAMPLE:** Taxpayer sells 100 shares of Tesla stock for $52,000 and realizes a gain of $10,000, he or she simply needs to invest $10,000 in a QOF in order to defer the tax. If the Taxpayer sells the interest in the QOF ten (10) years later for $25,000 the taxpayer would have a taxable gain of $8,500 even though the total gain was $25,000.

The Details

A QOF must invest in Qualified Opportunity Zone property, which must be located within a designated opportunity zone. Each state has designated its own zones. A QOF can be set up as either a partnership or corporation (limited liability companies are not addressed in the statute). To become a QOF, the Taxpayer self certifies by merely completing a form (to be released by the Internal Revenue Service) and attaching same to the Taxpayer's timely federal income tax return for the taxable year (with extensions, if any).

As stated above, in order for this work, the QOF must invest in Qualified Opportunity Zone Property which can be:

a) Qualified opportunity zone stock;
b) Qualified opportunity zone partnership interest; or
c) Qualified opportunity zone business property.

In short, the QOF must either do the investing itself by acquiring Qualified Opportunity Zone Property or acquire either stock or a partnership interest that does. The investments must take the form of original use (e.g., new construction) or acquiring property in the zones and making "substantial improvements" in an amount that equals the cost of acquisition.

Thoughts

Unlike IRC Sec. 1031 (Like-Kind Exchanges) which require re-investing the entire proceeds to achieve full tax deferral, new IRC 1400Z only requires that the gain be re-invested. Second, IRC Sec. 1031 presently only applies to real estate wherein Sec. 1400Z applies to any gain.

New Jersey has designated 75 municipalities with at least one opportunity zone.

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