

# QUALIFIED OPPORTUNITY FUNDS CREATE ONCE-IN-A-LIFETIME PLANNING OPPORTUNITY

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**New Internal Revenue Code Section 1400Z** creates qualified opportunity funds (QOFs) and qualified opportunity zones. This program incentivizes the reallocation of capital to designated low-income census tracts. It presents a remarkable opportunity for taxpayers to defer and reduce capital gain and subsequently exclude the appreciation of qualified opportunity fund interests from income.

Advisors should be mindful that taxpayers do not need to invest in syndicated real estate or other funds to use this program. Many taxpayers are forming their own “internal” QOFs (by forming limited liability companies taxed as partnerships). Aside from complying with the statutory requirements, the only difference between a QOF and another limited liability company is a statement of purpose in the organizing documents and a simple two-page self-certification form that is attached to the entity’s tax return.

## Potential Benefits

The program offers three primary tax-planning benefits:

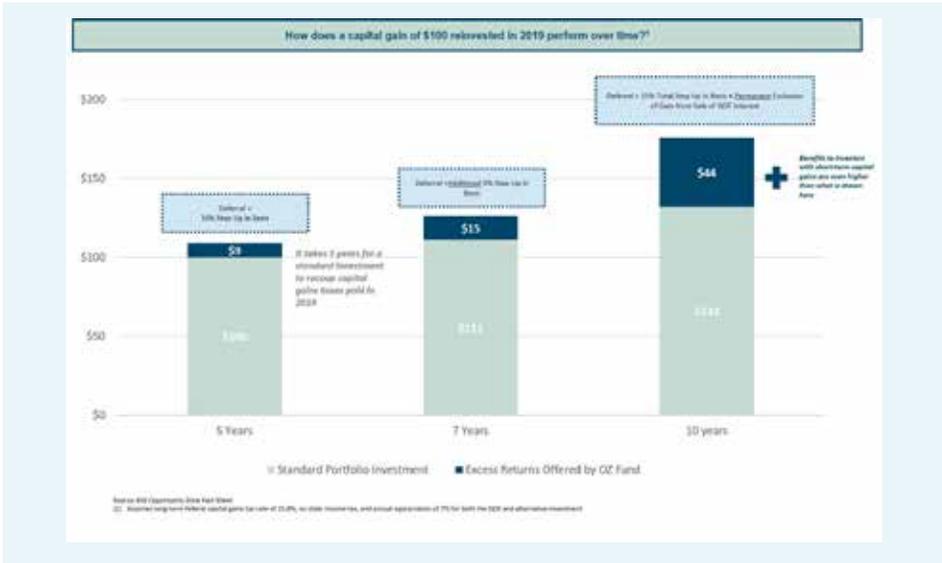
1. First, taxation of a realized, eligible capital gain that is timely reinvested in a QOF is deferred until the earlier of (i) the date that the QOF investment is sold or (ii) December 31, 2026. The present value of this deferral benefit, using a relatively conservative 5 percent discount rate, far exceeds the value of the forgiveness from taxation of up to 15 percent of the original gain.
2. Second, the amount of the deferred capital gain that is ultimately recognized and subject to taxation is reduced by 10 percent if the QOF interest is held for five (5) years and by an additional 5 percent to a total of 15 percent if the QOF interest is held for a total of seven (7) years by December 31, 2026. This would, for example, allow a \$10 million capital gain realized in 2019 to be taxed as an \$8.5 million capital gain on December 31, 2026.
3. Finally, if held for 10 years, taxpayers may make a tax-free sale of the QOF interest (the original deferred capital gain would

still be taxed, but only 85 percent of it). For taxpayers making a long-term investment, this back-end exclusion is the program’s most powerful benefit. Accordingly, taxpayers who reinvest a qualifying capital gain in a QOF on a date that is too late to maximize the value of the deferral and forgiveness benefits may still participate in, and materially benefit from, the QOF program.

## Basic Statutory Requirements

To qualify for the program, three general statutory requirements must be met:

1. First, the taxpayer must realize a capital gain from the sale or exchange of a capital asset with an unrelated party after December 31, 2017, and before December 31, 2026. Any capital gain is eligible. There is no requirement that the capital gain come from like-kind property. For example, a capital gain from the sale of stocks or bonds could be reinvested in a QOF that invests in real estate.
2. Second, the taxpayer must reinvest the deferred capital gain in a QOF within 180 days of the sale or exchange that triggered the gain. Under proposed regulations, owners of pass-through entities may reinvest the capital gain either within 180 days of the date on which the pass-through entity realized the capital or within 180 days of the last day of the pass-through entity’s tax year. Accordingly, owners of calendar-year pass-through entities that had eligible 2018 capital gains pass through to them are eligible to reinvest these gains into a QOF until June 29, 2019, regardless of when the gains were realized in 2018. This creates a potential second chance for taxpayers to timely reinvest 2018 capital gains into a QOF.
3. Finally, the QOF must invest at least 90 percent of its assets in qualified opportunity zone property. This includes stock in a domestic corporation that meets certain requirements, capital or profit interests in a domestic partnership that meets certain requirements, and tangible property used in a trade or business of a qualified opportunity fund that substantially improves the property.



estate project located within a qualified opportunity zone should qualify for the QOF program’s benefits. While uncertainty remains for multi-asset QOFs and operating companies, with proper planning, taxpayers can immediately take advantage of the program’s powerful tax benefits. ◀

**Current Status of the Program**

Prior to the issuance of the October 2018 proposed regulations, there was substantial uncertainty regarding the program and, consequently, little QOF activity. The October 2018 guidance, while not answering all questions, appears to provide sufficient clarity to allow taxpayers to confidently move forward with appropriate, carefully

structured QOF projects. A hearing on the October 2018 guidance was held on February 14, 2019, and additional guidance, which should answer at least some of the unanswered questions, is expected to be issued in March or April 2019.

Under the guidance issued to date, a capital gain timely reinvested in a single asset QOF formed to invest in a qualifying real



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