

ALERT: Capital gain deferral opportunity

August 24, 2018

The Tax Cuts and Jobs Act (TCJA) introduced a new federal incentive program targeted at improving certain economically distressed areas designated as Qualified Opportunity Zones (QO Zones). For investors, this creates significant tax incentives to invest in these areas.

If you have a capital gain recognized after January 1, 2018, you may be eligible to invest the gain into a Qualified Opportunity Fund (QO Fund) to access these benefits. The three tax incentive benefits of investing in QO Funds are:

1. Gain deferral – to Dec. 2026
2. Partial forgiveness of tax on the gain – up to 15 percent
3. Opportunity to exclude additional gains generated after investment in the QO Fund

QO Zone:

QO Zones are designated by the IRS and are economically-distressed areas where investment could improve the economic growth in these communities. Under the TCJA, the chief executive officer of each state (generally the governor) could designate certain census tracts that are low-income communities as QO Zones. The IRS certified the nominations and designated the QO Zones earlier this summer. The designation remains in effect for 10 years.

QO Fund:

A QO Fund is an investment vehicle organized as a partnership or corporation for the purpose of investing in a QO Zone. The QO Fund cannot invest in another QO Fund and must invest at least 90 percent of assets in QO Zone property. A penalty can apply to the QO Fund if it fails to meet the 90 percent requirement. There is no IRS approval required to be designated as a QO Fund. The Fund will include disclosures with its tax return each year to certify it is a QO Fund.

How the tax benefits work:

➤ Gain deferral

- If a taxpayer invests gains from the sale or exchange of property with an unrelated person in a QO Fund within the 180-day period beginning on the date of the sale or exchange, the taxpayer can elect to defer the gain from the sale or exchange.
- The taxpayer defers the gain until the earlier of the date on which the investment in the QO Fund is sold or exchanged, or Dec. 31, 2026.

➤ Partial forgiveness of the tax on the gain

- When the gain is invested in a QO Fund, the basis is zero. However, if the investment in the QO Fund is held for five years, the taxpayer's basis in the QO Fund increases by 10 percent of the original investment. If the investment is held for seven years, the taxpayer's basis increases by an additional 5 percent. The basis increase is a permanent deferral of the tax on the original gain.

➤ Gain exclusion

- If the taxpayer holds the investment in the QO Fund for 10 years or longer, the taxpayer can elect to exclude any post-acquisition capital gains on the investment in the QO Fund.

These benefits are limited to amounts of capital gains invested. Any amount invested in a QO Fund above the capital gain does not receive any special tax treatment.

Included with this alert is an example to demonstrate the tax benefits for an individual who sold stock in 2018 that resulted in a \$1 million gain.

As with almost all provisions from the TCJA, more guidance is needed from the IRS to clarify exactly how this new provision will work, especially which gains qualify to be invested in QO Funds. Stay tuned for more updates.

For more information on this opportunity, please contact your AGH tax advisor or AGH tax senior vice president Shawn Sullivan at 316.291.4110 or Shawn.Sullivan@aghlc.com.

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For additional information and maps of QO Zones, visit <https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>