STROOCK
**SPECIAL BULLETIN**

# When Opportunity Knocks to Defer Tax on Gains – "*Qualified Opportunity Funds*"

*July 17, 2018*

The 2017 Tax Reform Act[1] includes a new tax incentive provision that is intended to promote investment in economically-distressed communities, referred to as "Opportunity Zones." Through this program, investors can achieve the following three significant tax benefits:

1. The ability to defer -- potentially until December 31, 2026 – taxable gain realized on the sale or disposition of property to an unrelated person, to the extent such gain is reinvested in a "Qualified Opportunity Fund" within 180 days of the property's disposition;

2. The elimination of up to 15% of the gain that has been reinvested in a "Qualified Opportunity Fund" provided that certain holding period requirements are met; and

3. The potential elimination of tax on gains associated with the appreciation in the value of a Qualified Opportunity Fund, provided that the investment in the Qualified Opportunity Fund is held for at least ten years.

An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Internal Revenue Service (IRS). All Opportunity Zones have now been designated, as of June 14, 2018, and are available on the Treasury website.[2]

A Qualified Opportunity Fund, in turn, is an investment vehicle that is established as either a domestic partnership or a domestic corporation for the purpose of investing in eligible property that is located in an Opportunity Zone and uses investor gains from prior investments as a funding mechanism.[3] The investor can get the tax benefits

[1] The 2017 Tax Reform Act was enacted on December 22, 2017 and is commonly referred to as the "Tax Cuts and Jobs Act."

[2] *See* https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx

[3] In contrast to Section 1031 "like-kind" exchanges (another mechanism of gain deferral through reinvestment), in the Qualified Opportunity Zone context the cash from the sale does not need to be specifically tracked or escrowed: the requirement is merely that an amount of cash equal to the gain on the sale be

of Opportunity Zones even if the investor doesn't live, work or maintain a business in an Opportunity Zone – the investor just needs to invest in a Qualified Opportunity Fund. To become a Qualified Opportunity Fund, the entity self-certifies itself. The entity must meet certain requirements, in particular a general requirement that at least 90% of its assets be "qualified opportunity zone property" used within an Opportunity Zone, but no approval or action by the IRS is required. To self-certify, the entity merely completes a form which the IRS has said it expects to release during the summer of 2018, and then attaches that form to the entity's timely-filed federal income tax return for the taxable year (taking into account extensions).

## Deferral of Gain Through Timely Reinvestment in Qualified Opportunity Funds and Possible Exclusion from Income of Up to 15% of Such Gains if the Reinvestment is Held for At Least 7 Years

To qualify for these tax benefits, the investor's reinvestment in the Qualified Opportunity Fund must occur during the 180-day period beginning on the date of the sale that resulted in the gain that is to be "rolled over." If, during the 180-day period, the taxpayer's total investment in Qualified Opportunity Funds is an amount less than the taxpayer's total gain, the taxpayer may still elect to defer paying tax on that portion of its gain. If, in contrast, an amount in excess of the taxpayer's gain is transferred to the fund (a so-called "investment with mixed funds"), the taxpayer is treated, for tax purposes, as having made two separate investments -- one that only includes amounts as to which the investor's deferral election is made, and a separate investment consisting of other amounts.

Importantly, the law requires only that the ***gain*** be reinvested in the Qualified Opportunity Fund, and not the total sales proceeds. Subject to clarification by the U.S. Department of Treasury and the IRS, it would appear that the gain deferred could potentially be any type of gain (*e.g.*, short-term, long-term, ordinary or otherwise) in connection with the disposition of property.

The investor's tax basis in the Qualified Opportunity Fund is initially zero, but will be increased by 10% of the deferred gain if the investment in the Qualified Opportunity Fund is held for 5 years, and increased by an additional 5% (to 15% of the deferred gain in total) if the investment in the Qualified Opportunity Fund is held for 7 years. Thus, if a gain on the sale of property is timely reinvested in a Qualified Opportunity Fund, the taxpayer may be able to decrease the taxable portion of the originally deferred gain by 15% (via a corresponding basis step-up) if the investment in the Qualified Opportunity Fund is held for at least 7 years.

The investor must also make an election to defer the gain, in whole or in part, when filing the tax return for the tax year in which the tax on that gain would otherwise be due if it were not deferred.

## Exclusion of Gain on Appreciation in the Value of Qualified Opportunity Fund if Held for At Least 10 Years

The tax incentives of this program go well beyond tax deferral (even putting aside the potential basis adjustments discussed above), as subsequent gain on the appreciation in the value of the Qualified Opportunity Fund is capable of being ***fully excluded from income***. In order to qualify, the investor must hold its reinvestment in the Qualified Opportunity Fund for at least 10 years.

## So When -- and How -- Can Investors Get Started?

As noted above, investors wishing to utilize this newly enacted opportunity zone program must timely reinvest their gain in a Qualified Opportunity Fund within 180 days following the disposition of the property giving rise to such gain. The best time to start planning is before the

---

reinvested in a Qualified Opportunity Fund within 180 days.

investor disposes of its gain asset, as this will allow the investor the time to identify appropriate assets and Qualified Opportunity Funds.[4] Hopefully the IRS stays on target and releases its self-certification form for Qualified Opportunity Funds during the summer of 2018 to facilitate investment in Opportunity Zones and more readily enable investors to locate Qualified Opportunity Funds to take advantage of these tax benefits.

Stroock's Private Client Services Practice Group, and Tax Group, continue to monitor all developments in the family office space and in planning for wealthy individuals and their families, and will provide updates, including with respect to the U.S. Department of Treasury's and the IRS's issuance of guidance to address open points in the 2017 Tax Reform Legislation.

## For More Information


Anita S. Rosenbloom
212.806.6026
arosenbloom@stroock.com

Kevin Matz
212.806.6076
kmatz@stroock.com

Etta Brandman
212.806.6027
ebrandman@stroock.com

Sharon B. Soloff
212.806.6103
ssoloff@stroock.com

Jeffrey Uffner
212.806.6001
Juffner@stroock.com

Micah Bloomfield
212.806.6007
mbloomfield@stroock.com

Mayer Greenberg
212.806.6286
mgreenberg@stroock.com

Michelle M. Jewett
212.806.5835
mjewett@stroock.com

Bradley G. Kulman
212.806.6613
bkulman@stroock.com

Howard Lavin
212.806.6046
hlavin@stroock.com

Ronald J Stein
212.806.6018
rstein@stroock.com

Jerome A. Manning
212.806.6030
jmanning@stroock.com

Shifra Herzberg
212.806.1238
sherzberg@stroock.com

Michael S. Emanuel
212.806.6202
memanuel@stroock.com


[4] Investors may seek out Qualified Opportunity Funds established by others, or may create their own if they so choose; investors doing the latter should be particularly aware of the precise requirements under the statute for Qualified Opportunity Fund qualification.

New York
180 Maiden Lane
New York, NY 10038-4982
Tel: 212.806.5400
Fax: 212.806.6006

Los Angeles
2029 Century Park East
Los Angeles, CA 90067-3086
Tel: 310.556.5800
Fax: 310.556.5959

Miami
Southeast Financial Center
200 South Biscayne Boulevard, Suite 3100
Miami, FL 33131-5323
Tel: 305.358.9900
Fax: 305.789.9302

Washington, DC
1875 K Street NW, Suite 800
Washington, DC 20006-1253
Tel: 202.739.2800
Fax: 202.739.2895

www.stroock.com

This *Stroock Special Bulletin* is a publication of Stroock & Stroock & Lavan LLP. © 2018 Stroock & Stroock & Lavan LLP. All rights reserved. Quotation with attribution is permitted. This Stroock publication offers general information and should not be taken or used as legal advice for specific situations, which depend on the evaluation of precise factual circumstances. Please note that Stroock does not undertake to update its publications after their publication date to reflect subsequent developments. This Stroock publication may contain attorney advertising. Prior results do not guarantee a similar outcome.

Stroock & Stroock & Lavan LLP provides strategic transactional, regulatory and litigation advice to advance the business objectives of leading financial institutions, multinational corporations and entrepreneurial businesses in the U.S. and globally. With a rich history dating back 140 years, the firm has offices in New York, Los Angeles, Miami and Washington, D.C.

For further information about *Stroock Special Bulletins*, or other Stroock publications, please contact publications@stroock.com.