



nerej

From the real estate investors' perspective: 1031 exchange or Opportunity Zone? - by Patricia Flowers

March 29, 2019 - Spotlights

Patricia Flowers,
IBX1031

The final regulations are not out yet, but it's becoming clear that the 1031 Tax Deferred Exchange and the Opportunity Zone Fund (OZFs) are two very different programs that will be used for two different types of investments.

One of the most talked about programs to come out of the Tax Cuts and Jobs Act has been the establishment of Opportunity Zones, in which investments made to economically distressed census tracts are given preferential tax treatment. These areas are in need of assistance. Over half the communities eligible for designation as Opportunity Zones had fewer jobs and fewer businesses in 2015 than in 2000.

Local officials across the county designated such areas with the intended purpose of encouraging private equity, development and job creation in these distressed communities while providing taxpayer incentives by investing in OZFs. However as of this publication date there are still no final regulations, leaving many in the legal, accounting and real estate communities with questions.

As the nation's, largest Qualified Intermediary (QI) for 1031 Tax Deferred Exchanges, we are receiving many calls on OZFs. First it is important to note that OZFs are structured as a corporation or partnership and are not real estate. Therefore participating in an OZF cannot be a replacement property for an Exchange, nor can an investor use funds from the sale of an OZF as relinquished property for a new 1031 Exchange.

Taxpayers with gains on the sale non-real estate capital assets such as stocks, bonds, REIT shares, personal property, etc. could benefit from the OZF option, while those selling real estate still see the advantages of the 1031 program to defer capital gains tax and preserve equity. A few of the reasons are highlighted below:

- **Taxes Are Due in the End:** Only the gain from the OZ investment will be tax free at the end of the

10 year period. Taxes on the gain of the original capital asset sale will be due upon sale of the OZF or at the end of the 2026 tax year regardless. Since there is no specific end date for which capital gains tax are due on sale structured as a 1031 Exchange, many investors continue to reinvest tax deferred by exchanging property time and time again.

- **Step-up in Basis:** Investment in the OZ fund currently does not allow for a step-up in basis for the heirs upon the taxpayers death. With a 1031 Exchange, capital gains are forgiven upon death of the taxpayer meaning the heirs get a step-up in basis, - a big estate planning advantage.
- **Available Equity:** Over the years of ownership equity may be drawn on the exchange replacement property without tax recognition but it is not clear at this time how investors would be able to draw equity out of the OZ fund.
- **Any Location:** Exchangers may sell and buy business or investment use property anywhere in the United States. As noted above only designated addresses may be used as property in an Opportunity Zone.

As with any investments there are risks. Accordingly, it is essential that a potential investor seek the assistance of competent legal, tax and financial advisors to help them evaluate whether an OZ fund or the 1031 Tax Deferred Exchange is a better investment for them.

For those looking into the OZ fund, important questions to ask of the fund sponsor may be if their team is experienced in real estate investments and developments, do they understand the local community requirements for permitting, zoning, etc. and will they be able to adhere to those along with complying to the improvement requirements and timelines outlined in the Opportunity Zone regulations. This is important because the OZ fund must , substantially improve, the property and those improvements must be completed within 30 months.

Since the qualified Opportunity Zone program was first announced in the Tax Cuts and Jobs Act of 2017, the IRS released proposed regulations in October 2018. They are said to be working to revise those regulations with hopes of release in spring 2019.

Patricia Flowers is vice president of Investment Property Exchange Services, Inc. (IPX1031) and a Certified Exchange Specialist, Boston, MA.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540