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## The Opportunity of Opportunity Zones - by Justin Rostoff

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The Tax Cuts and Jobs Act of 2017 created what are known as Opportunity Zones. The benefits of Opportunity Zones, if structured correctly, are three-fold:

- Defer taxes on recognized capital gains until 12/31/26;
  - Decrease the taxable capital gains by up to 15%; and
  - Eliminate post-acquisition capital gains tax if held for minimum of 10 years.
- A few concrete points:

The tax incentives only apply to the investment of capital gains in opportunity zone property.

The capital gains can only be invested in a qualified opportunity fund (QOF) in exchange for stock/partnership interest(s).

Any domestic corporation or partnership may qualify as a QOF, which can be completely controlled and owned by the investor(s).

The below three examples illustrate how a real estate investor and/or developer may reap the benefits of the recently enacted opportunity zone legislation.

Example 1: A Corp. sells blackacre and recognizes capital gains of \$100. A Corp. then incorporates B Corp. to be a qualified opportunity fund, and within 180 days of sale of blackacre invests the \$100 into B Corp. in exchange for 100% of issued stock. B Corp. then buys whiteacre for \$100, which as it stands satisfies the requirements of opportunity zone property.

A Corp.'s taxes on the \$100 of capital gains are deferred to December 31, 2026.

On December 31, 2026, A Corp. has received a 15% step-up and now only has to pay capital gains

taxes on \$85.

On the 10th year and one day of B Corp. owning whiteacre, it sells it for \$400. B Corp.'s basis is calculated as market-value upon sale, therefore the \$300 is not recognized capital gains and goes untaxed.

Example 2: Same as example 1, except whiteacre costs \$200. A Corp. invests the \$100 of capital gains into B Corp. in exchange for 50% of issued stock. A Corp. then capitalizes C Corp. with \$100, which then invests same into B Corp. in exchange for the remaining 50% of issued stock. B Corp. then buys Whiteacre for \$200.

A Corp.'s taxes on the \$100 of capital gains are deferred to December 31, 2026.

On December 31, 2026, A Corp. has received a 15% step-up and now only has to pay capital gains taxes on \$85.

On the 10th year and one day of B Corp. owning whiteacre, it sells it for \$400. Because whiteacre was purchased with both capital gains and additional funds, A Corp.'s 50% of whiteacre realizes a gain of \$100, and only that \$100 will go untaxed. C Corp.'s 50% ownership will be treated as a normal investment therefore its \$100 in gains will be recognized and taxable.

Always to remember is that if land in an opportunity zone is improved by a building, then to reap the tax benefits, within 31 months of acquisition the purchaser must invest 100% of the building's basis back into the building. This includes demolition and construction costs.

Example 3: Same as example 1, except that whiteacre's \$100 is allocated as \$50 for land and \$50 for building.

A Corp.'s taxes on the \$100 of capital gains are deferred to December 31, 2026.

Within 31 months of acquisition, B Corp. must put at least \$50 of improvements into the building (100% of building's basis upon purchase).

On December 31, 2026, A Corp. has received a 15% step-up and now only has to pay capital gains taxes on \$85.

On the 10th year and one day of B Corp. owning whiteacre, it is sold for \$400. B Corp.'s basis is calculated as market-value upon sale, therefore the \$300 is not recognized capital gains and goes untaxed.

The time is ticking, as capital gains must be invested in a QOF by December 31, 2019 in order to qualify for the maximum 15% step-up. The next deadline will be on December 31, 2021, whereby the capital gains must be invested in order to receive a 10% step-up. But have no fear, even if capital gains are invested in a QOF after December 31, 2021 when both step-up deadlines have

expired, post-acquisition capital gains will still be eliminated provided the investment is held for at least 10 years.

This article is not legal advice. Please consult an attorney for counsel with regard to your individual circumstances.

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