

Qualified Opportunity Funds. The latest way to do well by doing good.

Impact investing—using wealth to create positive change in the world while also benefitting financially—has become increasingly popular. The idea of “doing well by doing good” often has investors reporting they have a more complete and fulfilling investing experience.

Now there’s a new type of impact investment—called **Qualified Opportunity Funds**—that is worth checking out if you’re looking to build wealth, reduce a capital gains tax, and improve communities across the country. For investors with these goals, the funds can potentially be a powerful part of an overall wealth plan.

SPARKING ECONOMIC GROWTH

Qualified Opportunity Funds invest in properties in economically distressed communities categorized as Qualified Opportunity Zones, which have been targeted for economic development.

These funds, which are generally formed as partnerships or corporations, can own a broad range of properties—from apartment buildings, to single family homes, to start-up businesses—that exist in Qualified Opportunity Zones. By investing in these funds, you can help give communities a much-needed economic boost.



BIG TAX INCENTIVES

Let’s say you have a taxable capital gain from the sale of appreciated property (investment assets, art, real estate, a business, for example). If you reinvest that gain in a Qualified Opportunity Fund within 180 days of the sale, you can potentially receive some compelling tax breaks. For example, you can:

- Defer realizing the gain as income and paying the capital gains taxes on the sale of the appreciated assets until December 31, 2026, or until the Opportunity Zone investment is sold (whichever comes first).
- Reduce the capital gains tax you pay by up to 15 percent because of an increase in the basis of the appreciated assets used to buy the fund interest.

IMPORTANT: The basis increases by 10 percent if you hold your interest in the Qualified Opportunity Fund for a minimum of five years. Hold it for seven or more years, and the basis increases another 5 percent reducing your tax impact by 15%.

BONUS: You can eliminate the capital gains tax due on the appreciation in the Qualified Opportunity Fund if you hold the fund for ten years or longer.

There are some important timing issues here. If you still hold the Qualified Opportunity Fund on December 31, 2026, you will recognize the gain on the deferred amount (taking into account any increases in basis). Therefore, to receive the 10 percent increase in basis, you would have to invest in a Qualified Opportunity Fund by the end of 2021. To get the additional 5 percent increase in basis, you would have to invest by the end of 2019.

Benefits of Qualified Opportunity Funds - Case Studies

The following hypothetical case studies help show the benefits that Qualified Opportunity Funds can potentially bring to different types of investors.

CASE STUDY 1 Business owner

Charly sells his business realizing \$12 million capital gain in October 2018. He locates three properties in two Qualified Opportunity Zones (QOZ) with a total purchase price of \$12 million. Charly creates his own Qualified Opportunity Fund (QOF) as a limited partnership fund, and his attorney ensures the partnership agreement contains appropriate language. He moves his \$12million gain into the QOF within the 180 day window and his CPA files his tax return claiming the QOZ deferral benefit.

If Charly holds the Qualified Opportunity Fund until December 31, 2026, his tax bill the following April will be ~\$589,000 *less* than he would have paid in 2018, assuming a federal rate of 23.8% and New Jersey of 8.97%. That big reduction stems from the 10 percent basis bump after holding the fund for five years and an additional 5 percent basis bump for holding the fund for seven years.

In addition, if Charly is in a lower tax bracket in 2026 than in 2018, he could pay less tax on the remaining gain than if he had realized it in 2018.

BONUS: If Charly waits at least ten years to sell the three properties in the fund, any gain on those properties will escape taxes entirely.

In the end, Charles would get these benefits:

- Almost eight years of federal tax deferral
- A 15 percent reduction on the deferred gain
- Tax-free proceeds on the sale of the qualified Opportunity Zone properties

CASE STUDY 2 Investment Portfolio Gains

Jamie, a successful attorney and partner at her large law firm, sold several securities in her trust brokerage account realizing a \$1 million gain in November 2018. She lives in Massachusetts which imposes a tax on top of her federal tax, which includes capital gains.

Jamie learns of a Qualified Opportunity Fund pool where she can invest all, or a portion, of her gains and defer the tax on her gains. The QOF pool uses her gains along with a few other investors to purchase, renovate and then lease multiple single-family homes that are in QOZs.

If Jamie holds the Qualified Opportunity Fund until December 31, 2026, her tax bill the following April will be as much as \$43,000 *less* than she would have paid in 2018, assuming 23.8% on federal and 5.05% on Massachusetts. Again, the 15 percent reduction in tax owed results from the 15 percent basis increase for holding the fund for seven years.

BONUS: If Jamie's real estate manager waits at least ten years to sell the QOZ properties in the fund, any gain on those properties will escape taxes entirely.



Next steps

Each state nominates communities as Qualified Opportunity Zones. They can be found by going to www.cdfifund.gov/Pages/Opportunity-Zones.aspx

You can invest in any of these zones—you're not limited to zones that are near you.

Interested investors can create their own QOF and identify and buy the QOZ properties themselves if they have real estate development capabilities in their personal networks.

Or, their fiduciary wealth manager may have access to networks with capabilities to offer QOF pools.



In either case, successful outcomes with the properties in the QOZ in most cases is more consequential and important than just the tax deferral and savings on the original gain.



David A. Witter, CFP®

Founder and CEO

Financial Harvest Wealth Advisors through our professional network is able to offer our clients access to qualified opportunity funds. Give us a call today if you have recently triggered a capital gain or are interested in impact investing to create positive change in the world while also benefiting financially.

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