CUMMINGS & LOCKWOOD LLC

INVESTMENTS IN OPPORTUNITY ZONES ALLOW INVESTORS TO DEFER AND POSSIBLY ELIMINATE CAPITAL GAINS AS POTENTIAL ALTERNATIVE TO 1031 EXCHANGES

On October 19, 2018, the U.S. Treasury Department released proposed regulations relating to the Opportunity Zones program, which is an investment tool established by the 2017 Tax Cuts and Jobs Act allowing investors in certain "Opportunity Zones" to defer and partially eliminate capital gains taxes on gains realized from selling real or personal property.

A typical "1031 Exchange" is a process whereby an investor can sell real estate and roll the capital gains from that sale into the purchase of another piece of real estate if certain conditions are met. The new Opportunity Zones program is similar to a 1031 Exchange in that it allows investors to roll capital gains from a sale of real estate, stock, or any other gain recognition event into special opportunity funds which are the investment vehicles for the qualified Opportunity Zones. However, the rules require substantial improvement-- equal to the acquisition cost-- to the property within 30 months of acquisition.

An "Opportunity Zone" is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as an Opportunity Zone if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation of authority to the Internal Revenue Service.

A "Qualified Opportunity Fund" is an investment vehicle set up as either a partnership or corporation for investing in eligible property that is located in an Opportunity Zone. To become a Qualified Opportunity Fund, the partnership or corporation must self-certify by filing Form 8996 together with its federal income tax return. The vehicle must hold at least 90% of its assets in Opportunity Zone property.

Unlike 1031 exchanges, there is no "like-kind" requirement for Opportunity Zone investments, but there are certain restrictions:

- Funds must be invested in the Qualified Opportunity Fund within 180 days of the date of sale of the asset;
- Eligible properties must be acquired within 6 months of contribution;
- Tax deferred until Dec. 31, 2026;
- If investment is held for 5 years, 10% of the capital gain will be excluded from income and avoid capital gains tax;
- If investment is held for 7 years, an additional 5% of the capital gain will be excluded from income and avoid capital gains tax; and
- Taxable gain is capped if investment is held for 10 years.

There are several potential tax benefits from investing in Qualified Opportunity Funds:

- Investors can defer tax on any prior gains invested in a Qualified Opportunity Fund until the earlier of the date on which the investment is sold or December 31, 2026.

- If the Qualified Opportunity Fund investment is held for longer than 5 years, there is a 10% exclusion of the deferred gain.
- If the Qualified Opportunity Fund investment is held for longer than 7 years, there is a 15% exclusion of the deferred gain. Note that this would require that the investment be made prior to December 31, 2019.
- If the Qualified Opportunity Fund investment is held for at least 10 years, the investor is eligible for a step-up in basis of the Qualified Opportunity Fund investment equal to its fair market value on the date that the investment is sold or exchanged. This results in nonrecognition of the appreciation in the Qualified Opportunity Fund.

The U.S. Treasury Department has approved 72 Opportunity Zones in Connecticut, including zones in Stamford, along the border of Greenwich. Click here for an interactive map of Opportunity Zones in Connecticut.

The U.S. Treasury Department has approved 427 Opportunity Zones in Florida. Click here for an interactive map.

The U.S. Treasury Department has approved 514 Opportunity Zones in New York. Click here an interactive map (zoom in on New York).

While the proposed regulations answer some questions, there is still a great deal of uncertainty with respect to Opportunity Zones including what happens upon the death of an investor. Anyone considering such investment should seek tax advice prior to entering into the transaction.