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Pathway to Tax Savings:

Tax Cuts and Jobs Act Provides Taxpayer Benefits through Opportunity Zones

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Have you been dreading selling stock because you don't want to pay tax on the capital gain? Have you recently sold your interest in an investment resulting in a capital gain? Are you looking for investors to help you start a new business? Well, the Tax Cuts and Jobs Act (TCJA) has a solution for you! And by the way, the sooner you jump on this opportunity, the better.

With the introduction of the TCJA came a plethora of new vocabulary. You can now add "Qualified Opportunity Zone" and "Qualified Opportunity Fund" to that list. Designed to bring investment in and potential job opportunities to economically distressed communities, this tax-saving mechanism has the potential to save you a lot of money, depending on the size of your investment.

Have I caught your attention yet? Here are a few things you need to know:

1) A Qualified Opportunity Zone (QOZ) includes specifically designated areas that are in need of economic development. Western New York currently has 44 QOZ's, which include 18 in Buffalo, one in Amherst, one in Lockport, and two in North Tonawanda. A full list of QOZ's can be obtained via the IRS website.
2) You must invest your capital gain in a Qualified Opportunity Fund (QOF), which is defined as "any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in Qualified Opportunity Zone Property…" (IRC Sec. 1400Z-2(d)(1)).
3) Your investment must take place within 180 days of the sale generating the capital gain in order to defer the payment of tax.
4) The longer you hold your investment in the QOF, the more benefit you receive –
    a. The tax deferment period is determined by the duration of time that your investment is held inside the QOF, or until Dec. 31, 2026, whichever is sooner.
    b. If you leave your investment in the fund for 5 years, you can increase your basis by 10%, resulting in taxation of only 90% of the original capital gain. You must invest by Dec. 31, 2021 to get this benefit.
    c. If you leave your investment in the fund for 7 years, you get an additional 5% increase in basis, resulting in taxation of only 85% of the original capital gain. You must invest by Dec. 31, 2019 to get this benefit.
    d. If you leave your investment in the fund for 10 years, you not only receive the benefit described in (c), but you also get to adjust the basis of your investment to fair market value at the time of sale. Therefore, if you invested capital gains totaling $800,000 and the fair market value rises to $1.2M after 10 years, you do not pay any tax on the $400,000 of appreciation.

Let's run through an example to illustrate how this works.

- Say you sell 1,000 shares of Amazon stock for $1,500 per share on June 30, 2019. You had purchased these shares in 2015 for $300 per share. The result of the sale is a capital gain of $1.2M, with taxes due of approximately $240,000. If you decide to invest this capital gain into a QOF within 180 days of the sale, you will be able to defer paying tax as long as your investment is held within the fund or until Dec. 31, 2026, whichever is sooner.
- If you leave the $1.2M in the fund for 5 years, your basis would increase by 10%, resulting in a taxable capital gain of only $1.08M.
- If you leave the $1.2M in the fund for 7 years, your basis would increase by 15%, resulting in a taxable capital gain of only $1.02M.
- Once Dec. 31, 2026 arrives, you must pay tax on the capital gain of $1.02M, calculated above, whether you keep your investment in the QOF or not.
- Now, say you decide to pull your investment out at the 10 year mark, in 2029. Over time, the fair market value of the investment has increased to $1.8M. Usually, you would need to pay tax on the appreciation of $600,000. However, since you kept your investment in the QOF for 10 years, you are able to step up your basis to the FMV, resulting in no gain and no tax due on the appreciation.

As you can see, savings can add up pretty quickly. Just in this example, you saved tax on between $120,000 - $180,000 of the original capital gain, as well as the tax on $600,000 of gain from your investment in the QOF. You were also able to defer paying the tax on your sale of Amazon stock for several years.

For more information, please contact Sarah DesJardins or your existing Dopkins contact:

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