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A Solution for 2023 Capital Gains: There is Still Time

Individuals with sizable capital gains are looking for proactive solutions to address their taxable event.

WHAT IS THE QUALIFIED OPPORTUNITY ZONE PROGRAM (“QOZ PROGRAM”)?

The QOZ program, made available under the 2017 Tax Cuts and Jobs Act, is one option gaining a lot of interest. The QOZ Program was created to encourage investment in designated communities across the U.S. by providing certain tax incentives in return for committing long-term capital to these communities through investment vehicles known as Qualified Opportunity Funds (“QOFs”). Generally, to receive the QOZ Program tax benefits, eligible capital gains must be reinvested in a QOF within 180 days from the sale of a capital asset. However, the QOZ Program final regulations released on December 19, 2019 provide additional flexibility for K-1 partnership gains including the ability of a partner to start his or her 180-day window on the date the partnership’s tax return is due, without extension (March 15th for a calendar year partnership).

WHAT ARE QUALIFIED OPPORTUNITY ZONES (“QOZs”)?


QOZs are designated census tracts throughout the United States that have been selected by state governors and certified by the U.S. Department of Treasury for inclusion in the QOZ Program. Each state governor was allowed to nominate up to 25 percent of the state’s qualifying census tracts for inclusion in the QOZ Program. In total, there are over 8,700 QOZs spread across all 50 states, D.C., and several U.S. territories.


Investors, which can be individuals and certain entities, may receive a combination of potential tax benefits when short and/or long-term capital gains are invested in a QOF and held for the required time-frame. A QOF is an investment vehicle organized as either a partnership or corporation that **invests at least 90% of its assets in Qualified Opportunity Zone Property (“QOZ Property”).** QOZ Property includes a wide variety of real estate and new or

existing businesses, including commercial real estate, housing, infrastructure, and start-up businesses located in QOZs. QOFs can hold single or multiple assets. The investments made by QOFs are intended to drive economic growth and job creation in the communities in which the investments are made.

UNDERSTANDING THE TAX BENEFITS

The potential tax benefits of investing in a QOF apply to federal income taxes and may also be available in certain states (see specific guidelines for appropriate state of residence). **The potential tax benefits fall into two primary categories:**

 **DEFERRAL** Generally, if a taxpayer invests the capital gain from the sale of a qualifying asset into a QOF within 180 days of recognizing the gain, taxes on such proceeds may be deferred until the earlier of December 31, 2026¹ or when the QOF investment is sold.

 **ELIMINATION** Investors who hold their investment for at least ten years receive a step-up in basis which means they pay no tax on the appreciation of their QOF investment upon disposition or through 2047, whichever occurs first, regardless of the size of the potential profit.² In addition, the step-up in basis eliminates any depreciation recapture tax that would otherwise be owed upon sale.

All investments involve risk, and the realization of the benefits is dependent on proper structuring and the structure and performance of the future investments selected. Not all investments will provide all of these benefits.

¹ A 10% step-up in basis was available for investments made prior to December 31, 2021 and an additional 5% step-up in basis was available for investments made prior to December 31, 2019.

² Assumes that the investor is a resident of a state that conforms with the QOZ Program or a no state income tax state, otherwise the investor will owe tax on any realized gain in investor’s state.

WHAT GAINS ARE ELIGIBLE?

Amongst other requirements, a gain is eligible for deferral if it is from the sale or exchange of property with an unrelated party (not more than 20 percent common ownership) and the gain is treated as a capital gain (short-term or long-term) for federal income tax purposes, including gains from:

- Stocks, bonds, options, hedge funds
- Primary and secondary residences
- Businesses, machinery, commercial buildings
- Land, livestock, art, wine, automobiles

The period to invest gains into a QOF and be eligible for the applicable tax benefits is generally 180 days from the date the gain would be realized for federal income tax purposes. However, there are now extensions allowing for more time.

K-1 PARTNERSHIP GAINS

The final regulations provide additional flexibility for K-1 partnership gains resulting in additional planning options for financial advisors. Assuming a calendar-year partnership, K-1 partnership gains realized on or after January 1, 2023, have until September 11, 2024 to complete an investment in a QOF. If the proceeds came from a blown 1031 exchange, investors may have additional time to complete a QOF investment.

WHAT NEXT?

Investors who have filed and/or paid capital gains taxes on 2023 or 2024 tax returns may still be able to complete a QOF investment. Due to the complexities of the QOF Program, individuals considering an investment in a QOF should consult a qualified professional for financial, tax, and legal advice.

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For additional information about the Qualified Opportunity Zone Program, contact Cantor Fitzgerald Asset Management at (855) 9-CANTOR or cfsupport@cantor.com.

Cantor Fitzgerald Co. (member FINRA/SIPC) | 110 E. 59th Street, New York, NY 10022 | cantorassetmanagement.com