

Qualified Opportunity Zones in Virginia

Tax-Deferral Opportunity on the Sale of Low-Basis Assets:

Are you considering selling stock, real estate, or a business that has substantially appreciated in value? Are you concerned with the capital gains tax that will accompany those sales?

The **December 2017 Tax Cuts and Jobs Act (TCJA)** provides a new tax incentive and potential solution for investors to defer, if not eliminate, capital gains tax on the sales of assets in exchange for investments back into Qualified Opportunity Zones (“QOZs”) across the Commonwealth. Read below for more details:



HOW IT WORKS

- ❑ The Qualified Opportunity Zones in Virginia were designated in May 2018 by Governor Northam. There are over 200 tracts that qualify (see map on page three).
- ❑ This new provision of the tax code, IRC §1400Z, rewards investors who purchase real estate or invest in eligible projects or businesses within the Opportunity Zones, by allowing them to **defer the capital gains tax from the sale of their appreciated assets if the capital gain portion is reinvested within 180-days back into a Qualified Opportunity Zone.**
 - If the QOZ investment is maintained for five years, you receive a 10% step-up in tax basis (in other words, you permanently avoid the capital gains tax on this portion),
 - If the investment is maintained for seven years, you receive an additional 5% step-up in tax basis,
 - A recognition event occurs on December 31, 2026, the end of the deferral period, based on the remaining unrealized gain, and
 - Any additional gain on the investment is completely excluded from income.
- ❑ For some investors, this may be a great opportunity to defer, if not eliminate, capital gains on the sale of low-basis property.

EXAMPLE

- ❑ Assume Jim sells stock this year that has a basis of \$25,000 for \$200,000. Three months later, he invests the capital gain, \$175,000, into qualified real estate within an Opportunity Zone.
- ❑ Jim avoids paying approximately \$30,000 in capital gains tax this year on the \$175,000 capital gain. He may also use his original \$25,000 basis for other investments (unlike a real estate §1031 Exchange that requires a taxpayer to reinvest the entire sales proceeds into a replacement property to defer tax).
- ❑ In five years Jim’s basis in the real estate investment is \$17,500 (10% step-up) and in seven years it is \$26,250 (15%). Jim permanently avoids paying capital gains tax on the step-up basis received.
- ❑ In December 2026, Jim still holds his real estate investment and must recognize the \$148,750 deferred gain (85%). This results in an approximately \$25,000 in tax, but 8 years of tax-deferral was achieved!
- ❑ **Assuming the real estate is then sold in 2030 for \$300,000, after averaging 6% annual growth, there is no additional tax payable on the sale (an additional approximately \$20,000 tax savings)**

OTHER CONSIDERATIONS

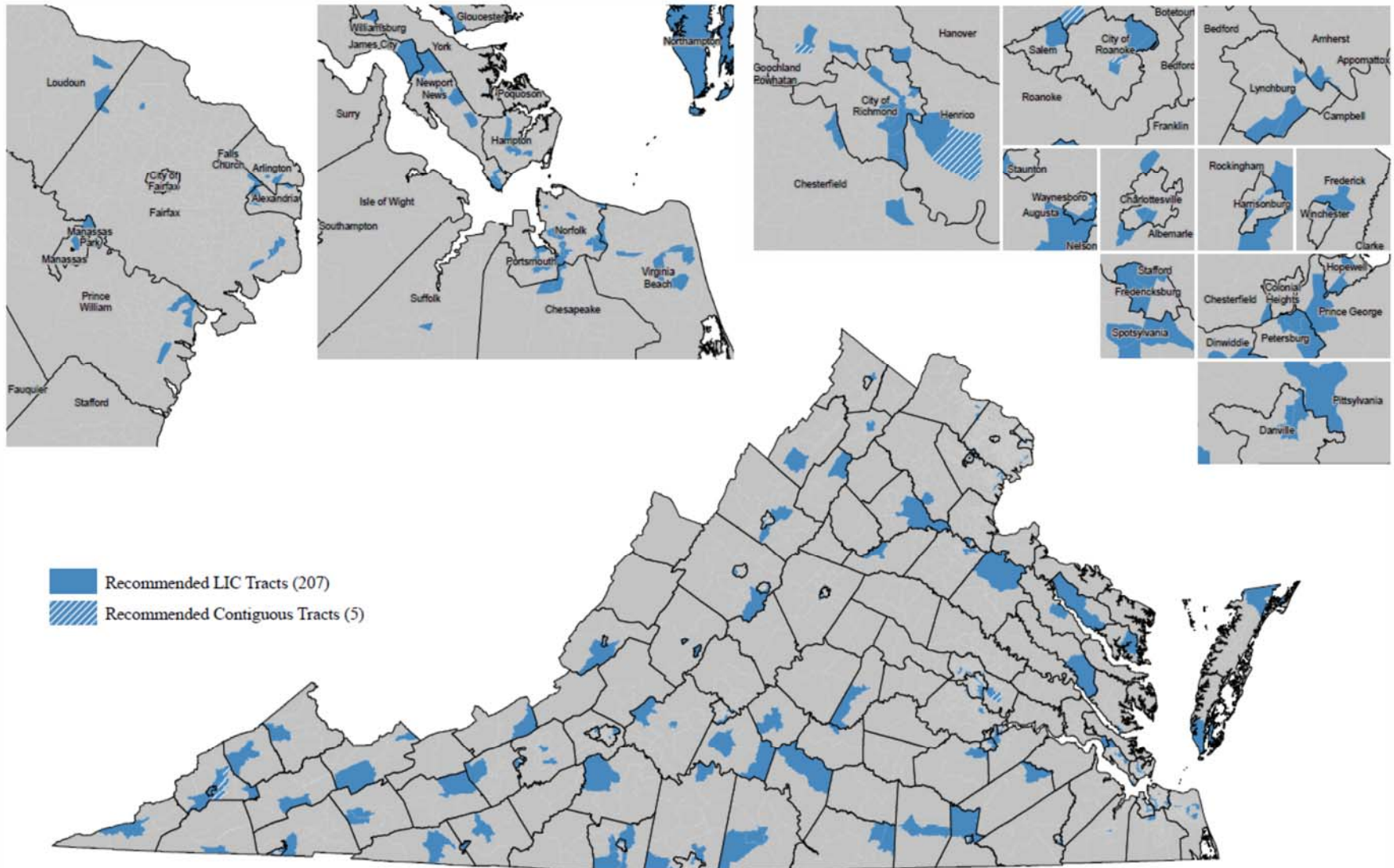
- ❑ Earlier investments in Qualified Opportunity Zones have the potential to reap the largest benefits from the additional years of tax-deferral and the five and seven-year basis step-ups, particularly those made by December 31, 2019.
- ❑ Restrictions on Qualified Opportunity Zone businesses and investments include but are not limited to:
 - For business investments to qualify, most of the ongoing business operations and tangible property must be within a QOZ,
 - Certain “sin businesses” are excluded (gambling facilities, golf courses, country clubs, massage parlors, etc.), like the rules for the New Markets Tax Credit, and
 - Business real estate qualifies, including commercial real estate rentals. However, there is a requirement that the real estate must be new or substantially improved over 30 months.
- ❑ It may be too early to invest in Qualified Opportunity Zones, as the IRS form for self-certification of an Opportunity Zone Fund is expected over the summer. We will keep you posted as additional guidance is issued.

Again, we expect more details to come in the next two months. In the meantime, if you have any questions or want to explore further, please do not hesitate to reach out – (804) 325-1450.

Margaret J. Smith, CPA, CFP®
Director of Tax and Financial Planning



Any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for (i) avoiding penalties imposed under the Internal Revenue Code or applicable state or local tax law or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.



Virginia Qualified Opportunity Zones