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## **Now May Be Good Time To Pull Opportunity Zone Investments.**

As some investors reevaluate their commitments to qualified opportunity zones in light of the novel coronavirus pandemic, they may enjoy some level of favorable tax treatment in 2020 if they decide to liquidate their capital from the funds.

While investors would likely consider multiple variables before deciding to take money out of QOZs — including the extent to which discrete funds allow for withdrawals, the stability of the market writ large and their ability to write off losses — the tax code has some advantages for those seeking to opt out of funds.

That's because the opportunity zone legislation, included in the 2017 Tax Cuts and Jobs Act and designed to offer tax relief for investments in low-income communities, doesn't levy interest-laden penalties on investors who choose to withdraw capital gains from funds. It even restarts the clock on the 180-day window for reinvesting in other funds without losing out on the program's favorable tax treatment.

And as investors brace for what may be prolonged economic instability, the tax treatment surrounding qualified opportunity funds is likely to play a role in their decisions to stick with current commitments or move capital gains into different areas.

"The risk of any investment is now higher" given the pandemic, Kate Kraus, partner at Allen Matkins, told Law360.

"People are definitely reevaluating whether they want to be invested in opportunity funds, and there are investors who are interested in pulling money out," Kraus said.

The opportunity zone program allows an investor who sells an asset and reinvests the gains in a QOZ fund to defer taxes on the gains until Dec. 31, 2026. It also forgives taxes on gains from investments held in opportunity funds for at least 10 years.

As of December, 8,764 census tracts had been designated as opportunity zones by state and local officials.

For individuals who sustain capital losses in 2020, liquidating their investments in opportunity funds would likely yield an advantageous tax position, Kraus said.

That's because whatever capital gains individuals had deferred by virtue of committing them to qualified opportunity funds in previous tax years would be recognized in 2020 if those investors decided to liquidate them this year, she said.

By doing so, those investors would be able to offset their capital gains and losses in 2020, she said, thereby reducing their tax liabilities.

While that “may not be the tax benefit people were looking for when they invested in opportunity funds,” Kraus said, it’s still better than sustaining a capital loss in 2020 because those losses can’t be carried back.

That calculus is made more advantageous given that final QOZ regulations issued by the Internal Revenue Service in December made clear that individuals wouldn’t be slapped with interest penalties, or any other kinds of penalties, if they chose to liquidate their investments early, David Shapiro, tax partner at Saul Ewing Arnstein & Lehr LLP, told Law360.

“For those who come into 2020 looking to liquidate, there’s no penalty and there’s no interest charge,” he said.

A key driving force for some investors is that they are simply “too nervous about what the state of the market is” to stick with their opportunity zone investments, James Null, partner at Eversheds Sutherland, told Law360. For those investors, “cash is king,” and they’d even be willing to take a tax hit on their capital gains in order to retain more control over their assets, he said.

Clients who are actively reevaluating their investments given the market’s current volatility are similarly looking for losses in 2020 — or even in 2019 — to offset previously deferred gains, Null said.

Still, the IRS may look askance at attempts to offset gains and losses by liquidating investments if the agency determines that those individuals lacked bona fide, good-faith intentions to follow through on those commitments, Null said, noting that the final rules also contained an anti-abuse provision.

In an example provided in the final regulations, the IRS said that individuals who direct their capital gains into opportunity funds they’ve established yet have no intention of actually investing in the projects would not be eligible to participate in the opportunity zone program.

Individuals interested in pulling their investments in QOZs in 2020 may also benefit from the ability to reinvest in other qualified opportunity funds within a 180-day window, Shapiro said. That’s because they’d effectively be recognizing a capital gain in 2020, and the 180-day window in which investors can place gains into QOZs begins whenever a capital gain is recognized, he said.

That may be an attractive option for individuals who have become dissatisfied with the funds they’ve invested in, Saul Ewing’s Shapiro said.

But there would also be diminishing returns if investors repeatedly liquidated gains that are parked in QOFs only to redeploy them into other funds later, Shapiro said, since investors may miss out on the increased levels of stepped-up basis.

One provision of the original opportunity zone legislation provides a 15% step-up in basis for investments made before Dec. 31, 2019, if those investments are held for seven years. After that window closes, investments can qualify for a 10% step-up in basis if they’re held for five years.

The ability to defer capital gains by investing in opportunity funds is set to expire in 2026, so the deadline for claiming a 10% step-up in basis is Dec. 31, 2021.

Investors who are evaluating the risks of sticking with various projects should also consider any limitations individual funds impose on withdrawals, Shapiro said.

Some funds may impose a penalty on individuals who opt out early, while others may prevent

withdrawals altogether for certain periods of time, he said.

The incentives for individual investors, who may be able to secure positive tax treatment if they choose to liquidate in 2020, are much different from those involved for the funds themselves, said Kraus at Allen Matkins. For the funds, there's little to no such upside to investors pulling out early, she said.

While that may be unfortunate for different funds, individuals may be looking at their investment portfolios anew in light of the pandemic.

"The tax benefit of a project is only as good as the project itself," Shapiro said.

### **Law 360 Tax Authority**

By Joshua Rosenberg · May 1, 2020, 4:00 PM EDT

-Editing by John Oudens and Neil Cohen.

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