J.P.Morgan

CFA Trending Topics

Week of October 29, 2018

4. Another look: Deconstructing equity market selloffs

Key Takeaways

- As pundits continue to anticipate a market correction, tax-sensitive investors may want to evaluate the opportunity to preserve gains from appreciated securities portfolios by investing capital gains in Qualified Opportunity Zones.
- U.S. Corporates with unrealized capital gains from cross-holdings could consider realizing and subsequently investing those capital gains in Opportunity Zones to signal sophisticated stewardship of capital.
- Corporates, individuals, and investors alike should be aware of possible knock-on effects of Opportunity Zones on real estate demand and bidding dynamics.

As part of the Tax Cuts and Jobs Act, Congress established the Opportunity Zones program aimed at spurring investment in low income communities. In essence, a taxpayer can elect to defer recognition of an unlimited amount of capital gain if that capital gain is reinvested in a Qualified Opportunity Fund ("QOF", which in-turn invests in Qualified Opportunity Zones) within 180 days. The Opportunity Zone provision rewards long-term investment - the longer a QOF is held, the bigger the tax savings. The benefits range from deferral of payment of capital gains tax until the investment in the QOF is sold, to a 10 - 15% step-up in tax basis (effectively resulting in forgiveness of a portion of the original gain), to an election to have the tax basis equal the fair market value of the investment if the QOF is held for at least 10 years (effectively resulting in forgiveness of all new gain in the QOF). Despite significant investor interest and public attention given to the Opportunity Zones program, practical questions remain and investors should consult with legal counsel and investment advisors before investing in QOFs to minimize risk of a technical misstep.

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