

Using Qualified Opportunity Zone Fund Investments to Limit Estate Tax Liability and Generate Tax Free Growth for Heirs

The enactment of the Investing in Opportunities Act in late 2017 created powerful tax benefits for investors with capital gains. Under the legislation, U.S. taxpayers who timely invest an amount equal to all or a portion of a realized capital gain into a Qualified Opportunity Zone Fund (“QOF”) can defer tax on such gain until December 31, 2026, and generate tax-free growth on appreciation of the QOF investment¹ in addition to other potential tax benefits depending on the structure of the QOF and its underlying investment strategy. An investment in a QOF can also create valuable estate planning benefits by allowing investors to maximize the assets they are able to transfer to their heirs tax-free.

One such strategy is to combine a QOF investment with an irrevocable grantor trust (“IGT”). For those not familiar with IGTs, they are a type of trust that, if structured appropriately, allows an individual to maintain oversight of the trust assets while effectively gifting the assets to their heirs. These structures have become especially popular due to the increased limit on lifetime gifts that was enacted under the Tax Cuts and Jobs Act of 2017, but time is limited. Today, the gift limit is \$13.61 million for an individual and \$27.22 million for a married couple. Anything over this limit may be subject to gift tax at a rate of up to 40% if gifted during the individual’s lifetime or up to the same amount if the assets remain in the individual’s estate upon their passing. While these gifting limits mean that the vast majority of U.S. taxpayers can minimize and potentially avoid tax on their estate if they pass away today, the current gifting limits are scheduled to sunset after 2025, at which time the limit will be halved to approximately \$7 million for individuals or \$14 million for a married couple. As a result, investors engaged in advanced tax planning are increasingly adopting the use of IGTs to effectively gift assets to heirs today before the higher gifting limit sunsets.

While IGTs are an effective tool to maximize tax planning at the higher gift tax exclusion, the downside is that once assets are transferred to the IGT, they aren’t eligible for the step-up in cost basis that would apply if the assets were transferred upon the death of the owner. Therefore, the trust, and by extension, its beneficiaries, could incur capital gains tax on any appreciation above the grantor’s cost basis. This limitation has historically made IGT’s less attractive for those individuals currently holding low basis, highly appreciated assets and/or assets that are expected to generate significant appreciation before the grantor’s death. However, the Opportunity Zone Fund legislation provides a unique strategy to overcome this limitation.

Because any appreciation in the value of a QOF investment is eliminated if the interest is held for 10 years or more, an individual can gift their low basis, highly appreciated assets to an IGT now, sell their position, invest the gain in a Qualified Opportunity Zone Fund and then pass through the entire value of the investment to their heirs completely tax-free. Capital gains tax would still be due on the amount of the gain originally invested into the QOF at the end of the deferral period, but since the tax rate on such gain is generally substantially less than the estate tax rate that would apply if the assets weren’t transferred, the grantor and their heirs could experience significant tax savings as a result of such a strategy.

1. There are exceptions for missed elections or an earlier Inclusion Event. Investors must hold their interest in a QOF Fund for at least 10-years in order to qualify for the elimination of capital gains tax liability with respect to appreciation in the value of the investment.

IN SUMMARY

Partnering an investment in a Qualified Opportunity Zone Fund investment with an Irrevocable Grantor Trust is one of the many ways that investors can leverage the QOZ legislation as a powerful estate and tax planning tool. The strategy outlined provides the opportunity to take advantage of today's higher gift tax exemption before it sunsets after 2025 while generating tax-free growth for an individual's beneficiaries. However, such a strategy is complex and should only be pursued in coordination with experienced tax and estate planning professionals.



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This material does not constitute tax advice to any person. A person must consult with his or her own tax advisors regarding the tax consequences to them of acquiring and owning any QOF investment.

THIS IS NEITHER AN OFFER TO SELL NOR A SOLICITATION OF AN OFFER TO BUY ANY SECURITIES. AN OFFERING IS MADE ONLY BY A PRIVATE PLACEMENT MEMORANDUM. THIS LITERATURE MUST BE READ IN CONJUNCTION WITH A PRIVATE PLACEMENT MEMORANDUM IN ORDER TO UNDERSTAND FULLY ALL OF THE IMPLICATIONS AND RISKS OF SECURITIES TO WHICH IT RELATES. A COPY OF A PRIVATE PLACEMENT MEMORANDUM MUST BE MADE AVAILABLE TO YOU IN CONNECTION WITH AN OFFERING.

Not all investors are suitable or qualify to invest into a QOF. You should always read the offering memorandum of any QOF and consult with your financial professional before investing into a QOF.

IMPORTANT RISK FACTORS

An investment in a Qualified Opportunity Zone Fund is subject to various risks, including but not limited to:

- To be eligible for the tax benefits associated with such funds, investors must comply with various requirements, as specified under Sections 1400z-1 and 1400z-2 of the U.S. Internal Revenue Code, and any U.S. Treasury and Internal Revenue Service guidance promulgated. Failure to comply with these requirements, or the failure of a given fund to qualify as a Qualified Opportunity Zone Fund, may result in a loss of all or a portion of the associated tax benefits. Investors should consult with their tax professional to determine their specific tax implications from an investment in such funds.
- Typically, no public market currently exists, and one may never exist, for the interests of any Qualified Opportunity Zone Fund. Qualified Opportunity Zone Funds are not liquid.
- Qualified Opportunity Zone Funds typically offer and sell interests pursuant to exemptions from the registration provisions of federal and state law and, accordingly, those interests are subject to restrictions on transfer.
- There is no guarantee that the investment objectives of any particular Qualified Opportunity Zone Fund will be achieved.
- Investments in real estate are subject to varying degrees of risk, including, among other things, local conditions such as an oversupply of space or reduced demand for properties, an inability to collect rent, vacancies, inflation and other increases in operating costs, adverse changes in laws and regulations applicable to owners of real estate and changing market demographics.
- The actual amount and timing of distributions paid by a Qualified Opportunity Zone Fund is not guaranteed and may vary. There is no guarantee that investors will receive distributions or a return of their capital.
- Qualified Opportunity Zone Funds that invest in for-lease properties depend on tenants for their revenue and may suffer adverse consequences as a result of any financial difficulties, bankruptcy or insolvency of their tenants.
- Disruptions in the financial markets and challenging economic conditions could adversely affect a Qualified Opportunity Zone Fund.
- Qualified Opportunity Zone Tax Benefits may not be available under state law and some states may impose their own requirements to qualify for the equivalent of the Qualified Opportunity Zone Tax Benefits under state law.
- An investment in a Qualified Opportunity Zone Fund is highly speculative.

Before purchasing interests, prospective investors should review a fund's offering memorandum, as may be supplemented from time to time, for more complete description of the risks and other disclosure related to participating in the offering.