The Ace of Basis:
I Saw the Sign . . . And It Is Changing the Face of Estate Planning

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Bernstein does not provide tax, legal, or accounting advice. In considering the information contained in this presentation, you should independently verify all conclusions before implementing any strategy on your own behalf or on behalf of your client.
# Comparative Highlights of Prior Law and “The Legislation Formerly Known as the Tax Cuts and Jobs Act”

## ATRA, et al.

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Top marginal corporate income tax rate</strong></td>
<td>35%</td>
<td>21%</td>
</tr>
<tr>
<td><strong>Top marginal individual income tax rate</strong></td>
<td>39.6%</td>
<td>37%, but up to 20% of domestic qualified business income is deductible</td>
</tr>
<tr>
<td><strong>Surtax on net investment income</strong></td>
<td>3.8%</td>
<td>Same</td>
</tr>
<tr>
<td><strong>Nonitemizers</strong></td>
<td>Combination of standard deduction and personal exemptions</td>
<td>2x standard deduction; personal exemptions eliminated</td>
</tr>
<tr>
<td><strong>Itemized deductions</strong></td>
<td>Subject to “3% cutback”</td>
<td>“3% cutback” and most deductions repealed; state and local tax deduction limited to $10,000 per year</td>
</tr>
<tr>
<td><strong>Estate and GST taxes</strong></td>
<td>$5.49M inflation-indexed exclusion; 40% “flat” rate</td>
<td>Same, except 2x prior basic exclusion amount through 2025 (now $11.58M)</td>
</tr>
<tr>
<td><strong>Step-up in income tax basis at death</strong></td>
<td>Applies to all decedent’s estates</td>
<td>Same</td>
</tr>
</tbody>
</table>

Federal Wealth Transfer and Income Taxes: Then and Now

- Basic exclusion amount
  - 2001: $675,000
  - 2020: $11.58 Mil.

- Transfer tax rate
  - 2001: 55%
  - 2020: 40%

- Income tax rates*
  - 2003: 15.0%
  - 2020: 23.8%
  - 2003: 35.0%
  - 2020: 40.8%

*The top income tax rates in 2020 include the 3.8% surtax on net investment income. The top ordinary income/short-term gain rate and qualified dividend/long-term gain rate in 2020 are 37% and 20%, respectively.
Sources: Internal Revenue Service (IRS) and AB
Tax Domicile of the Transferor—and Transferee—Matters

*Based on Health Care and Education Reconciliation Act of 2010, American Taxpayer Relief Act of 2012, and Tax Cuts and Jobs Act of 2017. Rates represent Bernstein’s estimate of the top marginal tax, federal and state income, capital gain, and estate tax brackets. Blended rates assume that state and local income taxes are not deductible for federal income tax purposes, notwithstanding the $10,000 deduction allowance for state and local taxes (including real property taxes) under current law, but that the 3.8% surtax on net investment income is adjusted to reflect the offset for state or local income taxes paid.
Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions.
Sources: www.taxfoundation.org, IRS, and AB
## Some Assets Will Benefit from Step-Up; Others May Not

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Tax Characteristic*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creator-Owned Copyrights, Trademarks, Patents, and Artwork</td>
<td>Ordinary Long-Term</td>
</tr>
<tr>
<td>Negative-Basis Commercial Real Property LPs</td>
<td>Ordinary and Long-Term</td>
</tr>
<tr>
<td>Artwork, Gold, and Other Collectibles</td>
<td>28% Long-Term</td>
</tr>
<tr>
<td>Low-Basis Stock</td>
<td>20% Long-Term</td>
</tr>
<tr>
<td>Roth IRA Assets</td>
<td>Tax-Free</td>
</tr>
<tr>
<td>High-Basis Stock</td>
<td>Minimal Gain</td>
</tr>
<tr>
<td>Bonds</td>
<td>Typically Minimal Gain</td>
</tr>
<tr>
<td>Cash</td>
<td>Basis = Face Value</td>
</tr>
<tr>
<td>Depreciated Stocks</td>
<td>Capital Loss Erased</td>
</tr>
<tr>
<td>Variable Annuities</td>
<td>Partially IRD**</td>
</tr>
<tr>
<td>Traditional IRA and Qualified Plan Assets</td>
<td>100% IRD**</td>
</tr>
</tbody>
</table>

*Tax rates cited below do not include the 3.8% surtax on net investment income.

**“IRD” means income in respect of a decedent.

Source: AB
Consider Likely Post-Transfer Appreciation, Not Just Gap Between Effective Estate and Capital-Gains Tax Rates

Is anticipated \([A_{pt} \times T_e] > [T_{cg} \times \{(V - B) + A_{pt}\}] \) ?;

where:

\[A_{pt} = \text{Post-transfer appreciation; }\]
\[T_e = \text{Transferor's effective } \text{estate} \text{ tax rate} \]
\[T_{cg} = \text{Transferee's effective } \text{income} \text{ tax rate} \]
\[V = \text{Current asset value} \]
\[B = \text{Current adjusted basis} \]

*Expected timing of transaction and transferor’s death are also key variables*
Consider Likely Post-Transfer Appreciation, Not Just Gap Between Effective Estate and Capital-Gains Tax Rates

Is anticipated \([A_{pt} \times T_e] > [T_{cg} \times (V - B) + A_{pt}]\) ?

where:

\[A_{pt} = \text{Post-transfer appreciation};\]
\[T_e = \text{Transferor’s effective estate tax rate};\]
\[T_{cg} = \text{Transferee’s effective income tax rate};\]
\[V = \text{Current asset value};\]
\[B = \text{Current adjusted basis};\]

*Expected timing of transaction and transferor’s death are also key variables*

Consider potential impact of increased exclusion on effective estate tax rate
For the “Lucky” Few to Whom the Estate Tax Still Applies . . .
Projected Effect of Inflation on Basic Exclusion Amount . . .

Basic Exclusion Amount
Nominal (USD Millions)

*Based on projected increases in “chained” CPI-U, rounded (except for 2020) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th (“high”), 50th (“median”), and 90th (“low”) percentile outcomes for the inflation-adjusted basic exclusion amount. Based on Bernstein’s estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.

Source: AB
... Unless We Get This

Basic Exclusion Amount
Nominal (USD Millions)

*Based on projected increases in "chained" CPI-U, rounded (except for 2020) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount. Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.

Source: AB
Potential Strategy: Lock in Today’s Still-Low Interest Rates . . . But Retain the Option to Complete the Gift Later

Applicable Federal Rates (AFR)
100% Annual Compounding

Source: www.irs.gov
How Installment Sale to Irrevocable (“Intentionally Defective”) Grantor Trust Works

Key points:
- Over time, Grantor transfers assets to IGT
- Collectively, transfers are treated as part-gift (10%), part-sale (90%)
- In exchange for assets sold, Grantor receives promissory note; interest payable annually for note term, with principal and final interest installment due upon maturity
- Until then, Grantor pays all income taxes on behalf of IGT and its beneficiaries
- Annual growth in excess of AFR may avoid gift, estate, and GST taxes*

*Potential benefit to trust and its beneficiaries equals post-transfer growth of assets given, plus growth of assets sold in excess of interest payable. “AFR” means applicable federal rate, annual compounding, as published by the Treasury Department. The mid-term AFR applies to fixed debt having a term greater than three years, but not greater than nine years; the long-term AFR applies to longer term loans; the short-term AFR to shorter term loans.

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Source: AB

If transaction is structured properly and Grantor fails to survive note term, value of note (not assets sold) will be subject to estate tax at Grantor’s death.
How Grantor Remainder Annuity Trust (GRAT) Works

Key points:
- Grantor transfers assets to GRAT
- Grantor receives annuity payments from trust during annuity term
- Grantor pays taxes on trust income
- If GRAT assets grow faster than Section 7520 rate (2.2% in February 2020), excess passes to Beneficiaries at end of annuity term free of gift tax
- If desired, “Beneficiaries” may be limited to Grantor’s spouse or irrevocable trust established for his/her benefit; if properly structured, assets in that trust should avoid estate tax at Grantor’s death and at Beneficiaries’ deaths

*If present value of annuity stream retained by Grantor equals value of assets contributed to trust, grantor makes no gift for gift tax purposes; GRAT is said to be “zeroed out.”

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Source: AB
Basis-Shifting: General Observations in the Current Environment
Five Ways to Get Basis

- Hold non-IRD asset until death (effective, but uncertain timing and not particularly pleasant)

- Receive an allocation of taxable income on a Schedule K-1 from a pass-through entity without a corresponding distribution (unpleasant if no offsetting tax losses)

- Incur debt

- Benefit from unique basis-shifting strategies that may be available Subchapter K

- Sale or exchange of qualified small business stock (QSBS)
Lifetime Estate Planning Strategies to Enhance Basis

- Retain assets until death rather than transfer them during life
- Establish a lifetime qualified terminable interest property (QTIP) marital trust for the benefit of the “poor” spouse (effective only to the extent funded at least one year prior to that spouse’s death)
- Establish a statutory community property trust in Alaska or Tennessee (an alternative to the controversial joint exempt step-up trust or “J EST”)
- Convert a traditional individual retirement account (IRA) to a Roth IRA
- Acquire life insurance and maintain that policy until death
- Reduce or eliminate valuation discounts for entities taxed as a partnership
- Incur mortgage debt and use the borrowed funds to engage in lifetime wealth transfer strategies—but ensure that the debt will be deductible as an administration expense under Section 2053

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Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
Case Study: Restructuring for Basis Step-Up at Death
Case Study: Current Business Structure

Jane Doe, Inc. (S corporation)

123 Main Street, LLC
Rent = $1,600 per month
1% voting
99% nonvoting

456 First Avenue, LLC
Rent = $3,400 per month
1% voting
99% nonvoting

Doe Family Trust (irrevocable grantor trust)
99% nonvoting

Government
All income taxes

Source: AB
Case Study: Possible Restructuring Ideas

**Converting a portion of the Doe Family Trust from “grantor” to “nongrantor” status may provide an opportunity to shift taxable business income to lower-bracket trust beneficiaries. Jane would be compensated, in part, for lost income through a reduction of her own income tax obligations. Multiple methods can be used to accomplish this result. Bernstein cannot render tax or legal advice; Jane should consult her own tax and legal professionals before implementing any of the ideas set forth in this presentation.**

*Converting a portion of the Doe Family Trust from “grantor” to “nongrantor” status may provide an opportunity to shift taxable business income to lower-bracket trust beneficiaries. Jane would be compensated, in part, for lost income through a reduction of her own income tax obligations. Multiple methods can be used to accomplish this result. Bernstein cannot render tax or legal advice; Jane should consult her own tax and legal professionals before implementing any of the ideas set forth in this presentation.*
Basis-Stripping Example
“Vertical Slice” Planning Concept: Increase the Inside Basis of an Asset Prior to its Sale

Planning concept

- Family limited liability company (LLC) contributes two of its assets—one highly appreciated asset that it wishes to sell to a third party and one depreciated asset—to a newly formed LLC (“Newco”)

- Family LLC then distributes all of its member interests in Newco, pro rata, to its own members—thus, Newco is a “vertical slice” partnership with the same capital structure as the original LLC

- Newco distributes the depreciated asset to elderly member (G1), who has zero outside basis in his member interest, in partial or complete redemption of G1’s interest in Newco

- Newco makes a Section 754 election effective for the taxable year of the distribution

Expected benefits

- Under IRC 732, the basis of the distributed asset in G1’s hands is reduced to zero (i.e., to G1’s outside basis), but that basis will be “stepped-up” to fair market value upon G1’s death

- Unlike basis adjustments under IRC 743(b), under IRC 734(b), an amount equal to that basis reduction is allocated among the remaining assets of Newco for the benefit of all its members—not just G1—and in this case, the only such asset is the highly appreciated asset that is about to be sold

- If G1 has a continuing interest in Newco, there potentially would be an additional—albeit partial—inside basis step-up to Newco’s remaining assets upon G1’s death

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Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
Vertical Slice Planning Concept: Initial Set-Up

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Sources: Paul S. Lee, "Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math)," 48th Annual Heckerling Institute on Estate Planning and AB.
Vertical Slice Planning Concept: Establish “Newco” LLC

Family LLC

G1 member (outside basis = $0)

Asset A: FMV = $5M, Basis = $0

Asset B: FMV = $2M, Basis = $4M

x%

y%

All outstanding member interests in Newco LLC

Planning steps shown in purple

Newco, LLC

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Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
Vertical Slice Planning Concept: Distribute Member Interests

Family LLC

x% interest in Newco

y% interest in Newco

G1 member (outside basis = $0)

G2 & G3 members

Asset A:
FMV = $5M, Basis = $0

Asset B:
FMV = $2M, Basis = $4M

Planning steps shown in purple

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Sources: Paul S. Lee, "Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math)," 48th Annual Heckerling Institute on Estate Planning and AB.
**Vertical Slice Planning Concept: Distribute Depreciated Asset to G1**

*For purposes of this illustration, we assume that distribution of Asset B to G1 is in complete liquidation of G1’s interest in Newco LLC. Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions. Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.*
Vertical Slice Planning Concept: Result of Distribution

Family LLC

0%  100%

G1

Asset B: 
FMV = $2M, Basis = $0

$4M of basis “disappeared”; where did it go . . . ?

G2 & G3 members

100% interest in Newco

Newco LLC

Asset A: 
FMV = $5M, Basis = $0M

*See Internal Revenue Code Section 732(b). For purposes of this illustration, we assume that distribution of Asset B to G1 is in complete liquidation of G1’s interest in Newco LLC. Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions.

Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
Vertical Slice Planning Concept: Basis Shift

- Family LLC
  - G1: 0%
  - G2 & G3 members: 100%

- Newco LLC
  - Asset A: FMV = $5M, Basis = $4M
  - Asset B: FMV = $2M, Basis = $0

If a Section 754 election is in place, basis goes here*

*See Internal Revenue Code Section 734(b)(1)(B).

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Sources: Paul S. Lee, "Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math)," 48th Annual Heckerling Institute on Estate Planning and AB.
Vertical Slice Planning Concept: Newco Sells Appreciated Asset

Planning steps shown in purple; expected result shown in green

Family LLC

G2 & G3 members

G1

0%

100%

100%

Asset A: FMV = $5M, Basis = $4M

Third party purchaser

$5M cash

Capital gain is $1M, rather than $5M

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Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
Vertical Slice Planning Concept: “Double Step-Up” at G1’s Death

Partial step-up in Family LLC’s assets . . . if Section 754 election is in place

Asset B: FMV = $2M, Basis = $2M

Expected results shown in green

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Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
Strategies that may provide a second basis “step-up” for credit shelter trust assets at the surviving spouse’s death

- Grant the surviving spouse a conditional general power of appointment (GPA) equal to her or his available applicable exclusion amount
- Empower a trust protector to create a testamentary GPA exercisable by the surviving spouse
- Give an independent trustee broad power to distribute principal to the surviving spouse prior to her or his death

Section 754 election to “step-up” the basis of the decedent’s proportionate share of assets held in a entity that is taxed as a partnership (i.e., “inside basis”)

- Amount of inside basis step-up is limited to the decedent’s “outside basis” step-up at death
- Only the estate and its successors-in-interest benefit from a post-mortem Section 754 election—not the other partners
Example of an “Upstream” Basis Planning Concept: “Accidentally Perfect” Grantor Trust . . . and a Puzzle

Planning concept

- Wealthy child (G2) transfers assets in trust for the benefit of “poor” parent (G1)
- At inception, G2 is the deemed owner of the trust assets for federal income tax purposes
- G1 is granted a testamentary GPA over some or all assets in that trust

Planning issue: Should G1 exercise the GPA or allow it to lapse?

- If the GPA is exercised
  - Assets to which the exercised power relate clearly receive a “step-up” in basis under IRC 1014(b)(4)
  - But G2 is no longer the deemed owner of the trust assets for federal income tax purposes
- If GPA lapses
  - G2 may still be deemed owner of the trust assets for income tax purposes
  - But the basis step-up may be reduced under IRC 1014(b)(9) by the amount of any prior amortization, depletion, and depreciation deductions taken by “the taxpayer”

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Qualified Opportunity Fund (QOF)
**Sixth Way to Get Basis**

- Hold non-IRD asset until death (effective, but uncertain timing and not particularly pleasant)

- Receive an allocation of taxable income on a Schedule K-1 from a pass-through entity without a corresponding distribution (unpleasant if no offsetting tax losses)

- Incur debt

- Benefit from unique basis-shifting strategies that may be available Subchapter K

- Sale or exchange of qualified small business stock (QSBS)

- **Qualified opportunity fund (QOF)**

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Sources: Paul S. Lee, “Venn Diagrams: The Intersection of Estate & Income Tax (Planning in the ATRA-Math),” 48th Annual Heckerling Institute on Estate Planning and AB.
**Special Rule for Capital Gains Invested in a “Qualified Opportunity Fund”**

- Broad deferral opportunity introduced in new Code Section 1400Z-2

- If taxpayer so elects, gross income for taxable year shall not include
  - Gain from sale or exchange
  - To or with unrelated party (except 20% test, rather than “normal” 50% test)
  - To extent invested in qualified opportunity fund (QOF)
  - Within 180 days after sale or exchange

- Immediate questions
  - Do only “capital gains” qualify (as suggested by the title to Code Section 1400Z-2)? Or do any “gains” qualify (as suggested by the statutory text)?
  - How to treat portion of gain that is deferred under other provisions, e.g., installment sale rules?
  - And just what the heck is a QOF!?

Sources: IRC § 1400Z-2(a) and AB
Deferral . . . With the Potential for Complete Elimination of a Portion of the Gain

- Gain on original investment is deferred until first to occur of
  - Sale or exchange of QOF interest; or
  - December 31, 2026

- When computing previously deferred gain
  - Investor’s basis generally is zero
  - Investor’s basis may be increased based on QOF holding period
    - If investor holds QOF interest for five years, basis is increased by 10% of deferred gain
    - If investor holds QOF interest for seven years, basis is increased by an additional 5%; however, post-2019 investments will not qualify due to 12/31/2026 gain recognition deadline
  - If investor holds QOF interest for 10 years, basis of that interest equals its fair market value upon disposition—no further taxable gain

- Observation: Deferral until 2026—when most of sunset—may be very valuable to some taxpayers (due to, e.g., restoration of most pre-2018 deductions)

Sources: IRC § 1400Z-2(b), (c) and AB
What Is a QOF?

- Investment vehicle
  - That is organized as corporation or partnership
  - For purpose of investing in “qualified opportunity zone property” … but not another QOF
  - And that holds at least 90% (measured twice per year) qualified opportunity zone property, which may include
    - Qualified opportunity zone stock
    - Qualified opportunity zone partnership interests, and
    - Direct ownership of qualified opportunity zone business property
  - Acquired after December 31, 2017 (i.e., apparently no preexisting funds or projects will qualify)

- To determine whether particular tangible property or business is located within “qualified opportunity zone,” as defined in Code Section 1400Z-1(a), see Notice 2018-48 and [https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx](https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx)

Sources: IRC § 1400Z-2(d) and AB
What Is “Qualified Opportunity Zone Business Property”?

- **Tangible** property
  - That is used in QOF’s trade or business
  - Is acquired by purchase after December 31, 2017
  - Either
    - Use of the property commences with the QOF; or
    - QOF substantially improves the property, so that basis more than doubles within 30 months
  - And substantially all such property is used in a qualified opportunity zone
- Severe penalty applies for each month during which QOF fails to satisfy 90% test
- “Sin businesses” (e.g., golf and country clubs; racetracks; liquor stores; massage parlors; hot tub, suntan, or gambling facilities) do not qualify*

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*Final regulations permit QOF to lease less than five percent of its rentable square footage to business described in IRC § 144(c)(6)(B). Treas. Reg. § 1.1400Z2-1(d)(4). Sources: IRC § 1400Z-2(d)(2)(D), (d)(3)(A)(iii), (f)(1), and AB
October 2018 Proposed Regulations Were Extraordinarily Taxpayer-Friendly . . .


- Published in Federal Register October 29, 2018

- Public hearing was held February 14, 2019

- Key features of October 2018 proposed regulations

  - Only capital gains* are eligible for deferral [Prop. Treas. Reg. § 1.1400Z-2(a)-1(b)(2)(i)(A)]

  - "Rollover" of entire** investment to new QOF permitted within 180 days [Prop. Treas. Reg. § 1.1400Z-2(a)-1(b)(4)(ii), Example 4(ii)]

  - Partnership may elect deferral or allow that right to pass through to its partners [Prop. Treas. Reg. § 1.1400Z-2(a)-1(c)(2)(ii)(B)]

  - Investor may dispose of QOF interest as late as December 31, 2047 [Prop. Treas. Reg. § 1.1400Z-2(c)-1(b)]

  - Working capital safe harbor for up to 31 months** [Prop. Treas. Reg. § 1.1400Z-2(d)-1(d)(5)(iv)(B)]

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*Final regulations clarify that "eligible gain" includes "qualified [Section] 1231 gain" not treated as ordinary income under Section 1245 or 1250. Treas. Reg. § 1.1400Z2(a)-(1b)(11)(i)(A), (iii).

**Final regulations permit rollover following disposition of just a portion of eligible taxpayer's QOF interest. Treas. Reg. § 1.1400Z2(a)-1(b)(11)(iv)(A), (B).


Sources: [www.irs.gov](http://www.irs.gov) and AB
... But May 2019 Proposed Regulations ... Not So Much

- See https://www.federalregister.gov/documents/2019/05/01/2019-08075/investing-in-qualified-opportunity-funds

- Published in Federal Register May 1, 2019

- Public hearing was held July 9, 2019

Key features of May 2019 proposed regulations

- QOF has six months to invest new capital and 12 months to reinvest sale proceeds [Prop. Treas. Reg. §§ 1.1400Z2(d)-1(b)(4), 1.1400Z2(f)-1(b)]

- Sale or exchange of QOF asset does not accelerate gain to investors under Code Section 1400Z-2, but may trigger gain recognition under other Code sections [Preamble, Section V.B]

- Transfer by gift is “inclusion event,” but transfer to grantor trust, and subsequent termination of grantor status upon deemed owner’s death, are not [Prop. Treas. Reg. § 1.1400Z2(b)-1(c)(3), (5)]

- Recipient of QOF interest due to investor’s death may “tack on” investor’s holding period [Prop. Treas. Reg. § 1.1400Z2(b)-1(d)(1)(iv)]

- Investor’s disposition of interest in QOF1 and reinvestment within 180 days in QOF2 “restarts the clock” on investor’s 10-year holding period [Preamble, Section IX; Prop. Treas. Reg. § 1.1400Z2(b)-1(d)(1)]

Sources: www.irs.gov and AB
December 2019 Final Regulations Retain Basic Approach and Structure of Proposed Regs


- Released December 19, 2019

- Generally effective 60 days after publication in Federal Register, but taxpayers may (and many likely will) opt in for prior taxable years

Key features of December 2019 final regulations

- Replace mandatory “netting” of Section 1231 gain from sale of business property with (i) deferral of gross gains, without regard to losses; and (ii) ability to elect date of sale, rather than end of entity’s taxable year, as start date for 180-day window [Treas. Reg. §§ 1.1400Z2(a)-1(b)(7)(i), (11)(iii)]

- Give partners, S corporation shareholders, and beneficiaries of trusts and estates three alternative start dates for 180-day window: (i) date of sale, (ii) end of entity’s taxable year, or (iii) due date without extensions for entity’s tax return [Treas. Reg. § 1.1400Z2(a)-1(c)(8), (9)]

- Eligible gains include gains realized under installment method, even if sale predated 2018 [Treas. Reg. § 1.1400Z2(a)-1(b)(11)(viii)]

- Nonresident aliens who incur capital gains that are effectively connected to US trade or business are “eligible taxpayers” [Treas. Reg. § 1.1400Z2(a)-1(b)(11)(ix)]

Sources: [www.irs.gov](http://www.irs.gov) and AB
**Comparison: $76.2 Million Traditional Investment Versus $100 Million in a QOF**

$Millions, Nominal

**Assumptions:**
1. Long-term capital gain tax rate = 23.8%
2. QOF taxed on 12/31/2026 after 15% basis adjustment
3. Invest in QOF within 180 days after recognizing $100M gain
4. Hold QOF for at least 10 years

<table>
<thead>
<tr>
<th></th>
<th>80/20 Liquid Portfolio*</th>
<th>QOF Breakeven**</th>
<th>QOF Moderate**</th>
<th>QOF Good**</th>
<th>QOF Great**</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual Return</strong></td>
<td>5.9%</td>
<td>3.6%</td>
<td>6.0%</td>
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<td>15.0%</td>
</tr>
<tr>
<td><strong>Millions, Nominal</strong></td>
<td>$112.1</td>
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<td>$139.2</td>
<td>$179.0</td>
<td>$285.7</td>
</tr>
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*“80/20 Liquid Portfolio” means 48% US stocks, 26% developed international stocks, 6% emerging markets stocks, and 20% intermediate-term municipal bonds. After-tax proceeds of $100M, taxed at 23.8%, left $76.2M available for investment in 2018. Portfolio compounded at 5.9% per year (based upon median estimate from Bernstein’s Wealth Forecasting System), resulting in $120.5M portfolio value after eight years, at which time portfolio was liquidated, triggering additional tax of $8.4M, and leaving a balance of $112.1M.

**“QOF” means fund that satisfies all requirements of Section 1400Z-2(d)(1) of the Internal Revenue Code of 1986, as amended. “Breakeven” means compound annual growth rate (CAGR) needed to achieve the same $112.1M of after-tax proceeds after eight years as the 80/20 Liquid Portfolio. “Moderate” means CAGR of 6%; “Good” means CAGR of 9%; “Great” means CAGR of 15%.

Data does not represent past performance, and is not a promise of actual future results or range of future results.

Source: AB
Comparison: $76.2 Million Traditional Investment Versus $100 Million in a QOF

$Millions, Nominal

Assumptions:
1. Long-term capital gain tax rate = 23.8%
2. QOF taxed on 12/31/2026 after 15% basis adjustment
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Source: AB

*BUT* pricing distortions in opportunity zones are affecting the breakeven percentage.

Comparison: $76.2 Million Traditional Investment Versus $100 Million in a QOF

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Source: AB