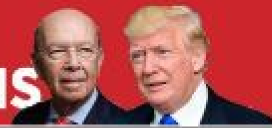
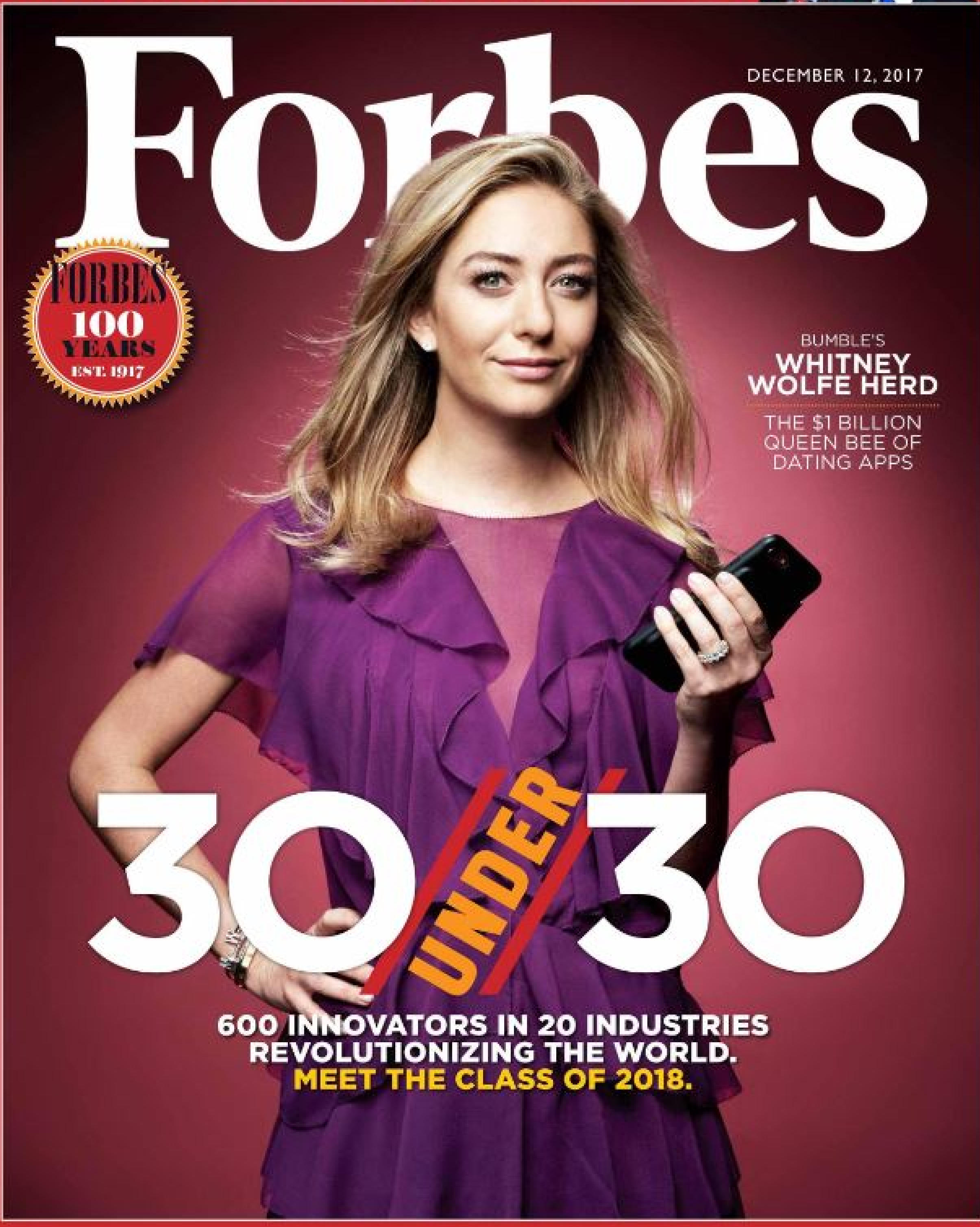
EXCLUSIVE:
WILBUR ROSS' PHANTOM BILLIONS



Forbes

DECEMBER 12, 2017

FORBES 100 YEARS EST. 1917



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The Wizard Of QOZ

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I apply a multidisciplinary approach to wealth management dovetailed with structured tax planning.
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In 1964, Henry Littlefield published an article in the *American Quarterly* that called L. Frank Baum's children's book *The Wonderful Wizard of Oz* a political parable on the U.S. populist movement at the end of the nineteenth century. In the book, Dorothy represented the average American citizen who sought the help of the wizard, who, according to Littlefield, represented the U.S. president at that time.

Fast forward to today: President Trump ran for office as a modern-day populist outsider breaking with party orthodoxy. Whatever side of the political fence you reside on, his ability to distance himself from his party's economic brand forged a decisive element of his appeal to at least a certain segment of working-class American citizens on either side of the political fence. His campaign was built on a variety of populist themes, such as bringing back jobs and investments into the U.S., rebuilding America's infrastructure and sweeping tax reform.

After becoming president, Trump signed into effect the Tax Cut and Jobs Act of 2017 (TCJA). With the TCJA, IRC Section 1031 imposed a strict limitation on like-kind exchanges to qualified real property. For real estate owners, one might say it was a win since the planning approach was not eliminated. The tax-deferral solution was not likely to be eliminated by a president whose family made their fortune with real estate. On the opposite end of the spectrum, for other capital asset owners who can no longer use like-kind exchanges to defer capital gains, it's a profound loss of a viable tax planning strategy. But the TCJA legislation contained a massive government-sponsored tax incentive that provides a new opportunity for financial planning. If you're looking for a way to reduce -- or eliminate -- capital gains, it may be time to seek the Tax Wizard of QOZ.

In response to lobbying efforts by the Economic Innovation Group (EIG), a bipartisan public policy organization, the U.S. Department of the Treasury allowed each state's governor to designate, by March 21, 2018, up to 25% of certain high-poverty, low-income areas as Qualified Opportunity Zones (QOZs). EIG was founded in 2013 by philanthropist and entrepreneur Sean Parker, most notable for co-founding the file-sharing internet service Napster and serving as the first president of Facebook.

The first set of QOZs released on April 9, 2018, only covered 18 states, but now zones are designated in all 50 states, the District of Columbia and five U.S. territories. These zones retain their designation for 10 years, through December

31, 2028. The Opportunity Zone tax incentive is designed to spur economic development, promote sustained economic growth and create jobs by rewarding long-term private investments in economically distressed communities nationwide.

On October 19, 2018, the IRS issued further and highly sought-after guidance relating to the operation of QOZs. It clarified that only capital gains from the sale or exchange of capital assets to an unrelated party are eligible for tax deferral. Capital gains are earned through the sale of appreciated capital assets, including art, collectibles, digital assets, franchise rights, patents and other intellectual property, which were all negatively impacted by the change to like-kind exchanges. EIG's analysis of Federal Reserve data found that an estimated $6.1 trillion in unrealized capital gains was held by U.S. households and corporations at the end of 2017. This represents an unprecedented tax planning opportunity for qualified investors.

The basic rule is that you must reinvest unrealized capital gains within 180 days of the sale or exchange. Alternatively, you may invest only a portion of the capital gains, but there's another catch. You can't invest directly into a QOZ. Instead, you must reinvest through a Qualified Opportunity Fund (QOF): an investment vehicle set up as a partnership or corporation for the exclusive purpose of pooling investments into a QOZ. These funds can invest directly in tangible or real property located in a QOZ or invest in a QOZ business, provided the business derives at least half of its income by owning or leasing a property in a QOZ. The beautiful thing is you don't need to live, work or have a business in one of these zones to capture the tax benefits. You only need to reinvest through a QOF in a timely manner. In contrast, in a like-kind exchange, the entire value of the original property must be reinvested before you can defer tax, and there is an array of cumbersome rules to qualify for the tax benefit.

How could a QOZ investment play out?

Real estate investor Oscar Diggs recently sold the Diggs International Hotel in Emerald City, resulting in a capital gain of $50 million. Mr. Diggs despises paying unnecessary taxes and has an inordinate amount of wealth to support his lifestyle. He strategically reinvests all the net sales proceeds in a QOF. Mr. Diggs benefits from deferred capital gains tax associated with the sale, following the yellow brick road laid out by the IRS. In 2023, five years from the initial investment, Mr. Diggs' seasoned capital gain would be reduced by 10% to $45 million. In 2025, his further seasoned capital gain would be reduced another 5%, for a total of 15%, to $42,500,000. In 2026, Mr. Diggs must pay tax on the sale of the hotel, but with the benefit of having the deferred capital gain partially forgiven. Instead of displacing his QOF investment, he strategically uses assets from his taxable estate to pay the tax. Mr. Diggs is a long-term investor and remains invested in the QOF through 2028. After the 10-year holding period, his entire investment in the QOF is sheltered; none of it is taxed, because it would qualify for a full step-up in cost basis. With a few strokes of a pen -- I mean, magic wand -- the Wizard of QOZ made his capital gains tax disappear.

Qualified Opportunity Zones create a win-win tax incentive with many financial planning applications. Companies such as Amazon, RXR Realty and SkyBridge Capital are aggressively jumping on QOZs. They see the opportunity to create massive economic development and prosperity for communities in need -- while keeping more of an investor's capital gains right where they belong.

After all, there's no place like home.

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