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Tax & Business Alert

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ROLLING OVER CAPITAL GAINS INTO A QUALIFIED OPPORTUNITY FUND

If you're selling a business interest, real estate or other highly appreciated property, you could get hit with a substantial capital gains tax bill. One way to soften the blow — if you're willing to tie up the funds long term — is to "roll over" the gain into a qualified opportunity fund (QOF).

WHAT IS A QOF?

A QOF is an investment fund, organized as a corporation or partnership, designed to invest in one or more Qualified Opportunity Zones (QOZs). A QOZ is a distressed area that meets certain low-income criteria, as designated by the U.S. Treasury Department.

Currently, there are more than 9,000 QOZs in the United States and its territories. QOFs can be structured as multi-investor funds or as single-investor funds established by an individual or business. To qualify for tax benefits, at least 90% of a QOF's funds must be "QOZ property," which includes:

QOZ business property. This is tangible property that's used by a trade or business within a QOZ and that meets certain other requirements.

QOZ stock or partnership interests. These are equity interests in corporations or partnerships, with substantially all their assets in QOZ property.

Note: Final regulations define "substantially all" to mean at least 70%.

WHAT ARE THE BENEFITS?

If you recognize capital gain by selling or exchanging property, and reinvest an amount up to the amount of gain in a QOF within 180 days, you'll enjoy several tax benefits.

Taxes will be deferred on the reinvested gain until the earlier of December 31, 2026, or the date you dispose of your QOF investment. There will be a permanent reduction of the taxability of your gain by 10% if you hold the QOF investment for at least five years, and an additional 5% if you hold it for at least seven years. If you hold it for at least 10 years, you'll incur tax-free capital gains attributable to appreciation of the QOF investment itself.

The only way to obtain these benefits is to first sell or exchange a capital asset in a transaction that results in

IRS ADDRESSES QOFS IN 2020 GUIDANCE

In February 2020, the IRS issued guidance on reporting gains from qualified opportunity funds (QOFs). It gives instructions on how to report the deferral of eligible gains from Section 1231 property and the inclusion of those gains when the QOF investment is sold or exchanged.

Taxpayers who defer eligible gains from such property, including gains from installment sales and like-kind exchanges, by investing in a QOF must report the deferral election on Form 8949, "Sales and Other Dispositions of Capital Assets," in the deferral tax year. And taxpayers selling or exchanging a QOF investment must report the inclusion of the eligible gain on the form.

gain recognition. You then would reinvest some or all of the gain in a QOF. You can't simply invest cash.

You or your heirs will eventually be liable for taxes on some or all of the original gain. Consider ways to avoid those taxes, such as holding the original property for life or doing a tax-free exchange.

WHO CAN HELP?

The rules surrounding these QOFs are complex. We can help you further explore the idea. ■

HEED THE LESSONS OF YOUR TAX RETURN AND CHECK YOUR WITHHOLDING

Every year's tax return provides valuable lessons on the optimal amount that taxpayers should have withheld from their paychecks. Heeding these lessons is especially important if you end up owing a substantial amount of money.

Of course, even if you got a nice tax refund, that shouldn't necessarily be your goal. It essentially means you're giving the government an interest-free loan. Here's a primer on why and how to review your withholding and change it, if necessary.

THE TCJA'S IMPACT

Following the passage of the Tax Cuts and Jobs Act (TCJA), the IRS updated the withholding tables that indicate how much employers should hold back from their employees' paychecks. In general, the amount withheld was reduced. This was done to reflect changes under the TCJA — including the increase in the standard deduction, suspension of personal exemptions and changes in tax rates.

The new tables provided a reasonable amount of tax withholding for some individuals, but they caused other taxpayers to not have enough money withheld to pay their ultimate tax liabilities. Although many people have since adjusted to the TCJA's impact, the IRS urges taxpayers to review their tax situations annually and adjust their withholding as appropriate.

The agency provides a withholding calculator to assist you. The calculator reflects tax law changes in areas such as available itemized deductions, the increased child credit, the dependent credit and the repeal of dependent exemptions. You can access the IRS calculator at https://bit.ly/2aLxK0A.

CIRCUMSTANCES THAT TRIGGER CHANGE

There are a variety of specific circumstances that should trigger you to check your withholding. For example, if you adjusted your withholding in

2019 — especially in the middle or later part of the year — give it another look. Also, as mentioned, if you got hit by a bigger tax bill than you expected, or received a sizable refund, you may want to make an adjustment.

Certain life changes typically warrant adjusting withholding as well. These include getting married or divorced, having a child or adopting one, buying a home, or incurring notable changes in income.

You can modify your withholding at any time during the year, or even multiple times within a year. To do so, simply submit a new Form W-4 to your employer. Changes typically go into effect several weeks after a new Form W-4 is submitted. (For estimated tax payments, you can make adjustments each time quarterly estimated payments are due. The next payment is due on Monday, June 15.)

WE CAN HELP

Contact us to discuss your situation and what you can do to remedy any shortfalls to minimize taxes due, as well as any penalties and interest. We can help you sort out whether to adjust your withholding. ■

BENEFIT WITH A TWIST: THE ROTH 401(K)

Most everyone has heard of a 401(k) plan, and a sizable number of adults likely have at least a passing familiarity with the Roth IRA. What remains less well known among job candidates and employees is the Roth 401(k) plan. This retirement benefit with a twist might be worth offering to your staff, so long as you and they understand how it works.

HYBRID PLAN

As the name implies, Roth 401(k)s are hybrid plans that take some characteristics from employer-sponsored 401(k)s and others from Roth IRAs. Any employer with an existing 401(k), 403(b) or governmental 457(b) plan can offer designated Roth 401(k) accounts.

From there, eligible employees can elect to defer part of their salaries to Roth 401(k)s, subject to annual limits. The employer may choose to provide matching contributions. For 2020, a participating employee can contribute up to $19,500 ($26,000 if he or she is age 50 or older) to a Roth 401(k). The most you can contribute to a Roth IRA for 2020 is $6,000 ($7,000 for those age 50 or older).

Note: The ability to contribute to a Roth IRA is phased out for upper-income taxpayers, but there's no such restriction for a Roth 401(k).

PROS AND CONS

Unlike with traditional 401(k)s, contributions to employees' accounts are made with after-tax dollars, instead of pretax dollars. Therefore, employees forfeit a key 401(k) tax benefit. On the plus side, after an initial period of five years, "qualified distributions" are 100% exempt from federal income tax, just like qualified distributions from a Roth IRA. In contrast, regular 401(k) distributions are taxed at ordinary-income rates, which are currently up to 37%.

Generally, qualified distributions are those made after a participant reaches age 59½ or because of a death or disability. Therefore, you can take qualified Roth 401(k) distributions in retirement after age 59½ and pay no tax, as opposed to the hefty tax bill that may be due from traditional 401(k) payouts. Roth 401(k)s follow the same required minimum distribution rules as traditional 401(k)s, but employees can avoid mandated withdrawals by converting a Roth 401(k) to a Roth IRA.

NOT FOR EVERYONE

A Roth 401(k) is more beneficial than a traditional 401(k) for some participants, but not all. For example, it may be valuable for employees who expect to be in higher federal and state tax brackets in retirement than in their working years. Contact us if you have questions about adding a Roth 401(k) to your benefits lineup. ■

A LARGE UNPAID TAX BILL COULD PUT YOUR PASSPORT AT RISK

Most Americans aren't using their passports right now. But it's still important to remember that, if the IRS certifies that you have a seriously delinquent tax debt (SDTD), your passport application could be denied, or your current passport could be limited or revoked.

You have an SDTD if 1) you owe more than $53,000 (as indexed for inflation) in back taxes, penalties and interest, 2) the IRS has filed a Notice of Federal Tax Lien, *and* 3) the period to challenge the lien has expired or the IRS has issued a levy.

Should you find yourself in this situation, there are several steps to take to avoid losing your passport. First, obviously, you can pay your tax debt in full immediately. If that's not possible, you may be able to pay your debt on a timely basis according to an approved installment agreement, accepted offer in compromise or settlement agreement with the Justice Department.

Requesting a collection due process hearing regarding a levy, or having collection suspended through a request for innocent spouse relief, may also enable you to retain your passport. More important, the IRS won't likely notify the U.S. State Department of an SDTD during a federally declared disaster, such as the one we've experienced this year, or in the case of bankruptcy, identity theft or other hardships. Contact us for more info. ■