WHEN OPPORTUNITY FUNDS AN ESTATE: ISSUES PRESENTED IN ESTATE PLANNING BY AN INTEREST IN A QUALIFIED OPPORTUNITY FUND PASSING DUE TO AN INVESTOR'S DEATH PRIOR TO DECEMBER 31, 2026 OR AN INCLUSION EVENT AND A COMPARISON OF PLANNING VEHICLES TO ALLEVIATE TAX BURDENS TO BENEFICIARIES

Michelle Huggins King

WHEN OPPORTUNITY FUNDS AN ESTATE: ISSUES PRESENTED IN ESTATE PLANNING BY AN INTEREST IN A QUALIFIED OPPORTUNITY FUND PASSING DUE TO AN INVESTOR'S DEATH PRIOR TO DECEMBER 31, 2026 OR AN INCLUSION EVENT AND A COMPARISON OF PLANNING VEHICLES TO ALLEVIATE TAX BURDENS TO BENEFICIARIES

ABSTRACT

Qualified Opportunity Zones, as specified in Section 1400Z-2, provide the potential for significant lifetime tax benefits through investment in designated areas, however, the Section does not provide as favorable treatment to beneficiaries of an interest in a Qualified Opportunity Fund. This Article discusses the issues presented in estate planning when dealing with Qualified Opportunity Funds and a number of strategies to alleviate potential tax concerns. Specifically, this Article explores how beneficiaries stepping into the shoes of the decedent investor proffers issues with liquidity, basis, continued deferment of the original gain, or, in the alternative, a potentially large tax liability in 2026. This Article will subsequently compare different planning vehicles with the potential to alleviate tax concerns to beneficiaries without triggering a recognition of the original deferred gain or forfeiting the other tax benefits of holding an interest in a Qualified Opportunity Fund.

Table of Contents

INTRODUCTION

As provided in Subchapter Z of the Tax Code,[1] comprised of Sections 1400Z-1 and 1400Z-2, Opportunity Zones, are an economic policy intended to revitalize some of the most economically distressed areas of the country.[2] To accomplish this goal, Section 1400Z-2 incentivizes investment of capital gains into certain designated zones through a series of tax benefits. To qualify, a taxpayer must reinvest his or her capital gains from the sale or exchange of any tangible or intangible asset in one of the designated zones within 180 days.[3] If the taxpayer does invest within the allotted time frame and meets the other requirements of Section 1400Z-2, there is the potential for substantial income tax benefits over time, which will be discussed in detail below. While Subchapter Z provides the potential for both significant improvements to the areas designated as Opportunity Zones and tax benefits for investors in these designated areas, Section 1400Z-2 was written with lifetime income tax benefits in mind and does not necessarily provide favorable treatment for beneficiaries of interests in Qualified Opportunity Funds after the death of the initial investor. With the issuance of the Final Regulations for Section 1400Z-2,[4] it became clear that the purpose of providing tax benefits to investors in Qualified Opportunity Zones only under strict rules and guidelines would not be thwarted by an investor's death and the subsequent passage of the investor's interest in a Fund to his or her estate, trust, or beneficiaries. Instead, beneficiaries of an interest in a Qualified Opportunity Fund are to step into the decedent investor's shoes.[5]

[1] All references are to the Internal Revenue Code of 1986, as amended (the "Tax Code," the "Code" or "I.R.C.").
[2] Background, Prop. Treas. Reg. § 1.1400Z-2, 83 Fed. Reg. 54278 (October 29, 2018).
[3] I.R.C. § 1400Z-2(a)(1)(A), 26 CFR Part 1(2017).
[4] Treas. Reg. § 1.1400Z2(a)-1 et. seq., 85 Fed. Reg. 1866 (March 13, 2020).
[5] I.R.C. § 1400-2(e)(2).

Although the written resources on Qualified Opportunity Zones in general is quite extensive two years after the passage of the Tax Cuts and Jobs Act, the resources specifically on estate planning are lacking, in part due to the Final Regulations only being published in the Federal Register on January 13, 2020. This Article will discuss how the provisions of Section 1400Z-2 and its corresponding Regulations impact estate planning. Particularly, this Article seeks to examine the issues that are presented both to the Qualified Opportunity Fund and the beneficiaries of the Fund interest upon an investor's death.

Through the issuance of the Final Regulations, Treasury and the Internal Revenue Service's stance was clarified regarding topics relevant to estate planning including the tax attributes of an interest in a Fund passed to a beneficiary upon a decedent investor's death, inclusion events, and specific ways that an interest in a Fund could be passed without triggering an inclusion event. The significance in the tax attributes of an interest in a Qualified Opportunity Fund in the hands of a beneficiary when planning is within a potentially large tax liability in the upcoming years for the beneficiaries and liquidity concerns if the estate does not have many other liquid assets. The Regulations provide that a beneficiary's basis in a qualifying investment to which Section 1400Z-2 applies is the same as if the qualifying investment were held by the decedent investor.[6] Consistently, the estate or the beneficiaries of the investment in the Qualified Opportunity Fund step into the shoes of the decedent investor and must continue to hold the investment for the relevant statutory periods or will have to pay tax on the deferred gain amount upon a sale, exchange, or disposition of the investment.[7] Thus, in the situation that an estate needs liquidity and has few other liquid assets, the beneficiary will be faced with a catch twenty-two of needing to continue to hold the investment to receive the tax benefits of Section 1400Z-2

[6] 85 FR 1866, Part II.A.3.D.5.
[7] *Id.*

due to the impending tax liability no later than December 31, 2026 and also needing to dispose of the investment in the case of an illiquid estate.

Clarification of which events cause inclusion, and which do not create both complications and planning opportunities in estate planning. Beyond recognition of the original deferred gain prior to December 31, 2026, the implications of an inclusion event are two-fold. First, which events cause inclusion and which do not present potential liquidity concerns both in the case of a decedent investor's estate and for beneficiaries of the Fund. Second, inclusion causes the qualifying investment in the Qualified Opportunity Fund to either be reduced or terminated entirely, which forfeits any remaining income tax benefits under Section 1400Z-2 corresponding to the reduced or terminated portion of the qualifying investment. However, the Final Regulations also clarified that transfers, including by gift, of an interest in a Qualified Opportunity Fund to a grantor or deemed grantor trust would not cause inclusion, which permits the use of several planning vehicles that have the potential to alleviate tax and liquidity concerns to beneficiaries by removing an interest in a Qualified Opportunity Fund from an investor's estate.

Following, different planning vehicles or techniques will be discussed with particular emphasis on whether the technique solves the issue of illiquidity of an estate and whether the technique reasonably protects the Qualified Opportunity Fund and the beneficiaries of the Fund. Specifically, this Article analyzes the use of grantor or deemed grantor trusts, including intentionally defective grantor trusts and grantor retained annuity trusts, life insurance and irrevocable life insurance trusts, and utilizing the investment in a Qualified Opportunity Fund as collateral and whether each vehicle, or a combination of vehicles, solves the above mentioned issues.

I. PART I: CLARIFICATIONS FROM THE FINAL REGULATIONS AND POTENTIAL ISSUES IN ESTATE PLANNING

A. SECTION 1400Z-2 BASICS

To fully grasp the estate planning implications of Section 1400Z-2 and the corresponding Regulations, it is important to first understand the basics.[8] As stated previously, if a taxpayer reinvests his or her capital gains from the sale or exchange of any tangible or intangible asset in a designated Opportunity Zone[9] within 180 days, Section 1400Z-2 provides the taxpayer with several favorable income tax benefits over time.[10] Specifically, Section 1400Z-2 provides three federal income tax incentives for investors in Qualified Opportunity Funds:[11] (1) deferral of capital gains invested in Opportunity Zone property[12] through December 31, 2026,[13] (2) partial exclusion of an aggregate 15 percent of the amount of the original gain invested in the Opportunity Zone through increases in basis upon a holding period of five and seven years,[14] and

[8] It seems prudent to note that this Article will be focusing on the basics of Section 1440Z-2. This Article's purpose is to provide guidance on tax and estate planning when dealing with investments in Qualified Opportunity Funds, not a comprehensive explanation of the Section.

[9] Section 1400Z-1 authorized the designation of the over 8,700 census tracks as currently designated as Opportunity Zones. *See* I.R.C. § 1400Z-1 (2017); *See also See* INTERNAL REVENUE SERV., LIST OF DESIGNATED QUALIFIED OPPORTUNITY ZONES (2018), https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx.

[10] I.R.C. § 1400Z-2(a)(1)(A).

[11] A Qualified Opportunity Fund is an investment vehicle that files either a partnership or corporation federal income tax return and is organized for the purpose of investing in Qualified Opportunity Zone property. *See Opportunity Zones Frequently Asked Questions*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions.

[12] Qualified Opportunity Zone property can be any of four alternatives: (1) tangible property that is used in a trade or business that is acquired by purchase in 2018 or later if the original use commences with that corporation or partnership (preexisting investments do not count); (2) substantial improvements to existing property can be qualified opportunity property if the improvement at least doubles the basis in the property (for example, if a house in the distressed community is purchased for $50,000, improvements of at least another $50,000 would be required for the improvements to constitute qualified opportunity zone property); (3) an investment in stock of a corporation that has qualified opportunity zone property; or (4) an investment in a partnership that has qualified opportunity zone property. *See* Steven R. Akers, *Planning Techniques for Large Estates 2019: Qualified Opportunity Funds-Overview and Planning Issues for Estate Planners*, The American Law Institute Continuing Legal Education.

[13] I.R.C. § 1400Z-2(b).

[14] I.R.C. § 1400Z-2(b)(2)(B)(iii)-(iv).

(3) exclusion of gain produced by the Qualified Opportunity Fund from the sale or exchange of an investment held longer than ten years.[15] Consider the following example:

EXAMPLE

> Assume ABC Partnership has Qualified Opportunity Zone Business Property with a basis of $1,000,000 that was sold for $6,000,000 on January 1, 2019. This creates taxable gain of $5,000,000 for ABC Partnership. If the $5,000,000 is reinvested by ABC Partnership in a Qualified Opportunity Fund within 180 days and stays invested, no tax will be due for the 2019 tax year.[16]
>
> To continue the example, the basis in the Qualified Opportunity Fund begins at $0 at the initial investment.[17] If ABC Partnership maintains the investment in the Qualified Opportunity Fund for five years, then ABC Partnership's basis in the Qualified Opportunity Fund has an upward adjustment of 10% to $500,000. This basis adjustment reduces the amount of deferral gain by the same 10% to $4,500,000.[18] Therefore, the deferred gain is reduced by $500,000 and the Qualified Opportunity Fund's basis goes up to $500,000. If the investment is maintained for seven years, the basis in the Qualified Opportunity Fund is increased by another 5% to a net $750,000. Therefore, the deferred gain is reduced by the same 5% to a net of $4,250,000.[19] Therefore, at the close of year seven, the deferred gain is reduced by $750,000 while the Qualified Opportunity Fund's basis is increased to $750,000.
>
> Assuming the Qualified Opportunity Fund does not lose value, no later than December 31, 2026, the remaining gain of $4,250,000 would become taxable.[20] In other words, the remaining 85% of the deferred gain that has not been impacted by the step ups in basis upon holding the investment for five and seven years becomes due. However, once the remainder of the gain is taxed, ABC Partnership's basis in the Qualified Opportunity Fund would also increase by $4,250,000 to a total of $5,000,000.[21] At this point, the first two income tax benefits, deferral of the originally invested gain, and reduction of the gain through adjustments to the basis of the initial investment, are complete.
>
> Continuing, if ABC Partnership were to continue to hold its interest in the Qualified Opportunity Fund for ten years or more, any capital gains produced by the Fund would be permanently excluded from the partnership's tax liability through a basis adjustment to the fair market value of such investment on the date that the

[15] I.R.C. § 1400Z-2(c).
[16] I.R.C. § 1400Z-2(a)(1)(A).
[17] I.R.C. § 1400Z-2(b)(2)(B)(i).
[18] I.R.C. § 1400Z-2(b)(2)(B)(iii).
[19] I.R.C. § 1400Z-2(b)(2)(B)(iv).
[20] I.R.C. § 1400Z-2(b)(1)(B).
[21] I.R.C. § 1400Z-2(b)(2)(B)(ii).

investment is sold or exchanged.[22] Accordingly, assuming that the basis in the Fund has remained at $5,000,000, if ABC Partnership sells its investment in the Qualified Opportunity Fund in 2030 for $7,000,000 and makes the applicable election, the basis will be adjusted to $7,000,000 to have the effect of the $2,000,000 in capital gains from the investment permanently excluded from tax liability.

As demonstrated above, the lifetime income tax benefits of investing in a Qualified Opportunity Fund can be significant. However, prior to the issuance of the Final Regulations and the preceding Proposed Regulations, the language of Section 1400Z-2 created uncertainties regarding planning opportunities and the impact that investing in a Fund could possibly have on an investor's beneficiaries if the Fund were to pass through an investor's estate. These questions included which transactions would constitute an inclusion event, the basis of an interest in a Fund upon the transfer of an interest due to the death of an investor, and whether an interest in a Fund could be transferred to a trust or other planning vehicles, among other topics. On December 19, 2019, the Treasury Department released Final Regulations for Section 1400Z-2. With the Final Regulations, many questions were answered and Treasury and the Internal Revenue Service's stance clarified regarding topics relevant to estate planning including inclusion events, the tax attributes of an interest in a Fund passed to a beneficiary upon a decedent investor's death, and specific ways that an interest in a Fund could be passed without triggering an inclusion event.[23] Through the Final Regulations, there is now a fairly clear picture of how an interest in a Qualified Opportunity Fund passes upon the death of an investor and how that interest will be treated for tax purposes in the hands of the beneficiaries.

[22] I.R.C. § 1400Z-2(c). As a note, this is accomplished through an election to have the basis adjusted to the fair market value of the investment on the date of the sale or exchange; it is not automatic.
[23] *See* 85 FR 1866, Part III.F.

B. INCLUSION EVENTS, EVENTS EXEMPTED FROM INCLUSION, AND CONSEQUENCES OF INCLUSION

One important clarification in the Final Regulations is which transactions or events will constitute inclusion events and which will not. Among the events that will not cause inclusion are the death of an investor, a transfer by reason of death, and a transfer to a grantor trust or deemed grantor trust. In contrast, any sale, exchange, or disposition by the decedent investor's estate, beneficiaries of the estate, or any other person, a transfer between spouses or incident to divorce, a grantor trust ceasing to be a grantor trust for income tax purposes, or the gift of an interest in a Qualified Opportunity Fund will cause inclusion.[24]

The significance of an inclusion event is far beyond simply recognition of the deferred gain earlier than December 31, 2026. Inclusion and the importance of avoiding inclusion also creates issues of liquidity and forfeiture of the benefits of Section 1400Z-2. Stated otherwise, the implications of an inclusion event are two-fold. First, which events cause inclusion and which do not present potential liquidity concerns both in the case of a decedent investor's estate and for beneficiaries of the Fund. Second, inclusion causes the qualifying investment in the Qualified Opportunity Fund to either be reduced or terminated entirely, which forfeits any remaining income tax benefits under Section 1400Z-2 corresponding to the reduced or terminated portion of the qualifying investment. The full implications of inclusion events will be discussed in Part I.B.3, below.

[24] Treas. Reg. § 1.1400Z2(b)-1(c)(3)-(4).

1. EVENTS THAT DO NOT CAUSE INCLUSION

a) DEATH OF AN INVESTOR AND TRANSFERS BY REASON OF DEATH

Regulation Section 1.1400Z2(b)-1(b)(4)(i) generally provides that the death of an investor will not cause inclusion.[25] Additionally, Regulation Section 1.1400Z2(b)-1(b)(4)(i) states that a transfer of a qualifying investment[26] by reason of the taxpayer's death continues to be a qualifying investment in the hands of the beneficiary and consequently, is not an inclusion event.[27] Treasury defined 'transfers by reason of death' to include a transfer to the decedent investor's estate, a distribution of a qualifying investment by the deceased investor's estate, a distribution of a qualifying investment by the deceased investor's trust that is made by reason of the investor's death, the passing of a jointly owned qualifying investment to the surviving co-owner by operation of law, and any other transfer of a qualifying investment at death by operation of law.[28] Thus, both the death of an investor and the subsequent transfer of the investor's interest in a Qualified Opportunity Fund in accordance with the investor's estate plan or to the natural heirs of the taxpayer's estate or by operation of law will not cause an inclusion event as to cause the tax on the deferred gains to become due or to jeopardize the investment's status as a qualifying investment in the hands of the beneficiary.

While the death of an investor and transfers by reason of death do not constitute an inclusion event, the Regulations provide that beneficiaries of a qualifying investment must include the interest in his or her gross income. Section 1400Z-2(e)(3) provides that in the case of

[25] Treas. Reg. § 1.1400Z2(b)-1(b)(4)(i).
[26] The significance of an investment remaining as a qualifying investment is that each of the holding periods for the income tax benefits under Section 1400Z-2 are testing the length at which the investor has held a "qualifying investment." If inclusion also terminates a qualifying investment, the income tax benefits remaining under Section 1400Z-2 will be forfeited.
[27] Treas. Reg. § 1.1400Z2(b)-1(b)(4)(i).
[28] Treas. Reg. § 1.1400Z2(b)-1(b)(4)(i)(A)-(E).

a decedent, a special rule requires an amount recognized under Section 1400Z-2, if not properly includible in the gross income of the decedent, to be includible in gross income as provided by Section 691.[29] In that specific case, the beneficiary that receives the qualifying investment has the obligation to include the deferred gain in gross income in the event of any subsequent inclusion event, including for example, any further disposition by that recipient. In other words, neither a transfer to an estate by reason of death or the subsequent transfer by the estate to a beneficiary will cause an inclusion event, but the beneficiary will step into the shoes of the decedent investor and will recognize the deferred gain amount upon a disposition of the investment or December 31, 2026. The tax attributes of an investment in the hands of a beneficiary will be further discussed in Part I.C., following.

b) TRANSFER TO A GRANTOR OR DEEMED GRANTOR TRUST

Importantly, if the owner of a qualifying investment contributes it to a trust and the contributing owner of the investment is the deemed owner of the trust, the contribution to the grantor trust is not an inclusion event.[30] Similarly, a transfer of the investment by the grantor trust to the trust's deemed owner is not an inclusion event.[31] If, however, the wholly grantor or deemed grantor trust ceases to be treated as a grantor trust for income tax purposes, the change in grantor trust status is treated as an inclusion event.[32] Additionally, the creation of grantor trust status of a trust holding an interest in a Qualified Opportunity Fund will also cause inclusion.[33] The consequences of termination or creation of grantor or deemed grantor trust status for any

[29] 85 FR 1866, Part II.A.5.
[30] Treas. Reg. § 1.1400Z2(b)-1(c)(5)(i).
[31] *Id.*
[32] Treas. Reg. § 1.1400Z2(b)-1(c)(5)(ii).
[33] *Id.*

reason for income tax purposes are significant to the health of a Qualified Opportunity Fund and continued deferral of the deferred gain and will be examined in depth below.

2. TRANSFERS THAT CAUSE INCLUSION

Exempted from events that comprise 'transfers by reason of death', and thus occasions that cause inclusion, are transactions including: a sale, exchange, or other disposition by the deceased taxpayer's estate or trust, other than a distribution described above, any disposition by the legatee, heir, or beneficiary who received the qualifying investment by reason of the taxpayer's death, and any disposition by the surviving joint owner or other recipient who received the qualifying investment by operation of law on the taxpayer's death.[34] Additionally, a transfer of an interest in a Qualified Opportunity Fund between spouses or incident to divorce as described in Section 1041, constitutes a disposition of that interest for purposes of Section 1400Z-2(a)(1)(B) and (b) and accordingly, the transferor's deferred gain is recognized, and the transferee's interest in the Qualified Opportunity Fund no longer is a qualifying investment.[35] Treasury further noted in the Final Regulations that a transfer by gift of an interest in a Qualified Opportunity Fund would cause inclusion.[36]

The only exceptions to the above rules that any sale, exchange, or gift of an interest in a Fund causes inclusion and termination, at least in part, of the qualifying investment is in the specific case of transactions between grantors and grantor trusts. A grantor is permitted both to gift his or her interest in a Fund to a grantor or deemed grantor trust[37] and to sell the interest to

[34] Treas. Reg. § 1.1400Z2(b)-1(b)(4)(ii)(A)-(C).
[35] Treas. Reg. § 1.1400Z2(b)-1(c)(3).
[36] *See* 85 FR 1866, Part III.F.
[37] *Id.*

the grantor or deemed grantor trust.[38] In addition to explicitly stating that a gift to a grantor or deemed grantor trust would not cause inclusion, the Final Regulations also provide that:

> If the owner of a qualifying investment contributes it to a trust and, under [the grantor trust rules], the contributing owner of the investment is the deemed owner of the trust, the contribution to the grantor trust is not an inclusion event….Such contributions may include transfers by gift or ***any other type of transfer between the grantor and the grantor trust that is a nonrecognition event as a result of the application of the grantor trust rules***.[39] (emphasis added)

While not immediately apparent, this exception to the rule encompasses sales to a grantor trust as such transactions are not recognition events for Federal income tax purposes under the grantor trust rules.[40] These important exceptions to the general rule regarding transactions and events that cause inclusion will be examined in greater detail in Part II in discussion of grantor trusts as effective estate and gift tax planning vehicles for Qualified Opportunity Funds.

3. SIGNIFICANCE OF AVOIDING AN INCLUSION EVENT

As stated above, the implications of an inclusion event are two-fold. First, which events cause inclusion and which do not present potential liquidity concerns both in the case of a decedent investor's estate and for beneficiaries of the Fund. Second, inclusion causes the qualifying investment in the Qualified Opportunity Fund to either be reduced or terminated entirely, which forfeits any remaining income tax benefits under Section 1400Z-2 corresponding to the reduced or terminated portion of the qualifying investment.

a) LIQUIDITY

There are two separate potential liquidity issues presented by the provisions of Section 1400Z-2 and the corresponding Regulations: (1) illiquidity in a decedent investor's estate and (2)

[38] Treas. Reg. § 1.1400Z2(b)-1(c)(5).
[39] *Id.*
[40] *See* Rev. Rul. 85-13 (February 19, 1985).

beneficiary illiquidity when the deferred tax of a Fund received by reason of the decedent investor's death becomes due. The beneficiaries of a Fund stepping into the shoes of the decedent investor gives rise, in part, to both potential liquidity concerns. Because a beneficiary of a Fund is required to continue to hold the investment in the Qualified Opportunity Fund for the applicable holding periods in Section 1400Z-2 as to take advantage of the corresponding tax benefits, it is foreseeable how a Fund could create liquidity issues in an otherwise illiquid estate. In the case of a decedent investor dying prior to holding his or her investment in the Fund for ten years or longer and with an illiquid estate, the estate and beneficiaries are faced with a difficult decision of needing liquidity to pay administration expenses and potentially estate taxes but also needing to continue to hold the investment in the Qualified Opportunity Fund as to not forfeit the remaining tax benefits. Further, because the deferred gain would become due upon the sale or exchange of the Fund, the sale or exchange to create liquidity in the estate could create further liquidity issues if there is not liquidity to pay the tax on the deferred gain. To address this issue, Part II pays particular attention to whether a planning vehicle is effective at removing a Qualified Opportunity Fund from a decedent investor's estate.

The second liquidity concern is that of potential illiquidity of the beneficiaries upon an inclusion event or December 31, 2026, whichever occurs first, when the tax on the deferred gain is due. Practically speaking, beneficiaries stepping into the shoes of the decedent investor requires the beneficiaries to hold the investment in the Fund for the remaining holding periods prescribed by Section 1400Z-2. The beneficiaries will consequently also be responsible for the tax on the deferred gain on or before December 31, 2026. Thus, beneficiaries will want to avoid an inclusion event and continue to hold the investment, at minimum, through the seven year holding period as to take full advantage of the basis increases and corresponding deferred gain

reduction under Section 1400Z-2 as to reduce the tax on the deferred gain when it becomes due. However, even with the aggregate 15 percent basis increases upon holding an investment in a Fund for seven years, beneficiaries are faced with paying the tax on the remaining 85 percent of the deferred gain of the Fund. It is foreseeable that beneficiaries may not have the liquidity to pay the tax on the deferred gain if the liquidity is not provided to them. In the case that the decedent investor's estate was illiquid, the beneficiary may not have received further liquidity to cover the cost of the tax. When presented as a concern during the comment period for the Final Regulations for Section 1400Z-2, Treasury and the Internal Revenue Service declined to make any allowances for beneficiaries of a Fund.[41]

In a comment letter submitted June 27, 2019, the American College of Trust and Estate Counsel ("ACTEC") expressed concerns regarding the above-mentioned liquidity issues.[42] In an example set forth in its comment letter, ACTEC described the issue with having a beneficiary tack on the holding period of the decedent investor as the beneficiary may not have the liquidity to pay the potentially large tax liability by or before December 31, 2026, and even if the beneficiary wished to sell the interest, the secondary market may not have matured by that time. Specific to this issue, ACTEC proposed two competing mitigating techniques: (1) to allow the

[41] Treasury and the Internal Revenue Service recognize that liquidity issues may arise in this particular instance but did not wish to make changes to the structure of Section 1400Z-2 to mediate these concerns. In Part III.F. of T.D. 9889, Treasury stated: "[o]ne commenter noted that the recipient of a deceased owner's qualifying investment may not have the liquidity to pay the deferred tax on the gain the decedent investment in the QOF upon on inclusion event as of December 31, 2026. The commenter requested that the Final Regulations permit an election to treat death as an inclusion event, thereby making the decedent's estate liable for the payment of the deferred tax or grant the recipient a further deferral until the recipient's disposition of the qualifying investment. The Treasury Department and the Internal Revenue Service note that, if a decedent who dies after 2026 had not disposed of the qualifying investment prior to December 31, 2026, it is possible that even the decedent could have faced such a liquidity problem. In light of the statute's clear direction that the deferral be terminated no later than December 31, 2026, the Final Regulations provide no further deferral to a person inheriting the qualifying investment as a result of the deceased owner's death." 85 FR 1866, Part III.F.2.

[42] The American College of Trust and Estate Counsel, *Comment Letter on Proposed Regulations on Qualified Opportunity Funds under Code Section 1400Z-2* (June 27, 2019), https://www.actec.org/assets/1/6/Comments_on_Proposed_Regulations_on_Qualified_Opportunity_Funds_under_Code_Section_1400Z-2.pdf. [*hereinafter* ACTEC Comment Letter].

beneficiary an election to treat the decedent investor's death as a recognition event for income tax purposes, and (2) to allow the beneficiary to be able to continue to defer the gain under Section 691, including after December 31, 2026, until the time that the beneficiary disposes of the interest in the Qualified Opportunity Fund.[43]

As we know from the Final Regulations, Treasury and the Internal Revenue Service declined to adopt either approach to dealing with beneficiary illiquidity.[44] In the explanation to the Final Regulations, Treasury and the Internal Revenue Service note that, if a decedent who dies after 2026 had not disposed of the qualifying investment prior to December 31, 2026, it is possible that even the decedent could have faced a liquidity problem.[45] Consequently, due to the statute's unambiguous language that the deferred gain be recognized no later than December 31, 2026, and Treasury and the Internal Revenue Service's clarification that death will not be treated as an inclusion event, neither an election to treat death as an inclusion event nor further deferral for a beneficiary who receives an investment in a Qualified Opportunity Fund by reason of the investor's death were added to the Final Regulations.[46]

Thus, while it is consistent with the purpose of Section 1400Z-2 that a sale or exchange by either the estate for the beneficiaries be exempted from transfers that do not constitute an inclusion event, this provides the potential for liquidity issues.[47] Where liquidity issues are likely to be an issue if an investor's interest in a Qualified Opportunity Fund is transferred by reason or his or her death, it may be especially prudent to transfer the investment to a vehicle that removes the investment from the investor's estate and to consider providing a means to pay any

[43] ACTEC Comment Letter at 6.
[44] *See* 85 FR 1866, Part III.F.2.
[45] *Id.*
[46] *Id.*
[47] *See Id.*

foreseeable tax liability produced by the investment. The techniques available to accomplish these goals will be discussed in Part II.

b) REDUCTION OR TERMINATION OF A QUALIFYING INVESTMENT

The Regulations clarified that transactions described as inclusion events result in a reduction or termination of a qualifying investment's status as a qualifying investment to the extent of the reduction or termination, except as otherwise provided in Section 1.1400Z2(b)-1(c) or the other provisions of the Section 1400Z-2 Regulations.[48] This reduction or termination of the qualifying investment status applies for purposes of Section 1400Z-2(c), the special rule for investments held for at least 10 years, as well as Section 1400Z-2(a)(1)(B) and (b), treatment of gains and deferral of gains invested in opportunity zone property.[49] In other words, reduction or termination of a qualifying investment applies for purposes of the tax benefits associated Section 1400Z-2. Thus, an inclusion event causes a forfeiture of any remaining tax benefits under the Section.

Consistently, the Regulations define an inclusion event as a transaction that reduces or terminates the Qualified Opportunity Fund investor's direct or, in the case of partnerships, indirect, qualifying investment for Federal income tax purposes or, in the case of distributions, constitutes a "cashing out" of the eligible taxpayer's qualifying investment in a Qualifying Opportunity Fund.[50] For that reason, and to that extent, the taxpayer holding the reduced investment in the Qualified Opportunity Fund after the inclusion event no longer possess a qualifying investment.[51] The Treasury explained that the benefits provided under Section 1400Z-2(c) generally are available only to a taxpayer that not only makes an equity investment in a

[48] 85 FR 1866, Part II.A.5.
[49] *Id.*
[50] *Id.*
[51] *Id.*

Qualified Opportunity Fund described in Section 1400Z-2(e)(1)(A)(i), but that also then continuously maintains that qualifying investment throughout the statutorily prescribed holding periods.[52]

One important instance in the area of estate planning that causes a termination of the qualifying investment is termination or creation of grantor trust status for income tax purposes. If a grantor has transferred his or her interest in a Qualified Opportunity Fund to a grantor trust that ceases to be a grantor trust for any reason, the investment will no longer be a qualifying investment.[53] The inverse is also true. If an investor holds his or her investment in a Qualified Opportunity Fund in a nongrantor trust that is later deemed to be a grantor trust for income tax purposes, the creation of the grantor trust status terminates the qualifying investment.[54] As discussed above, to receive the tax benefits of partial exclusion of an aggregate 15 percent of the amount of the original gain invested in the Opportunity Zone through increases in basis upon a holding period of five and seven years,[55] and exclusion of gain produced by the Qualified Opportunity Fund from the sale or exchange of an investment held longer than ten years,[56] the taxpayer must hold a "qualifying investment" in the Qualified Opportunity Fund for the stated holding periods. Accordingly, if the grantor trust ceases to be a grantor trust or grantor trust status is created in a trust holding an investment in a Qualified Opportunity Fund for any reason, the taxpayer not only must recognize the deferred gain, but the qualifying investment is terminated and any remaining tax benefits under Section 1400Z-2 are forfeited. Consequently, as will be discussed in Part II of this Article, while a grantor trust may be an effective vehicle to

[52] *Id.*
[53] Treas. Reg. § 1.1400Z2(b)-1(c)(5)(ii).
[54] *Id.*
[55] I.R.C. § 1400Z-2(b)(2)(B)(iii)-(iv).
[56] I.R.C. § 1400Z-2(c).

alleviate liquidity concerns by having an interest in a Qualified Opportunity Fund not includible in a decedent's estate, if the grantor trust ceases to be a grantor trust for income tax purposes for any reason, an inclusion event is triggered, the tax on the deferred gain will become due, and the investment will cease to be classified as a qualifying investment.

In summary and in accordance with the Final Regulations, the following events will not constitute an inclusion event: the death of an investor, the transfer of an interest in a Qualified Opportunity Fund to a decedent investor's estate, a distribution to beneficiaries of the estate, or a transfer to a grantor trust or deemed grantor trust, including by gift or sale. On the other hand, the following events will cause inclusion: any sale, exchange, or disposition by the decedent investor's estate, beneficiaries of the estate, or any other person, a transfer between spouses or incident to divorce, or a grantor trust ceasing to be a grantor trust for income tax purposes.[57]

C. Tax Attributes of an Interest in a Qualified Opportunity Fund in the Hands of an Estate, Beneficiary, or Other Qualifying Person or Vehicle

1. Basis of Qualifying and Non-Qualifying Investments

In addition to providing guidance on which events would cause inclusion, the Final Regulations clarified the tax attributes of an interest in a Qualified Opportunity Fund as it relates to an interest passed due to the death of an investor. When determining the basis of an interest in a Qualified Opportunity Fund in the hands of a beneficiary, the Final Regulations provide for two separate basis valuations based upon whether an investment is a qualifying or non-qualifying investment under Section 1400Z-2.[58] Where the two separate basis valuations arise is where a taxpayer contributes gain from the sale or exchange of any tangible or intangible asset along with other funds, or where a taxpayer elects to treat only a portion of gain contributed as a qualifying

[57] Treas. Reg. § 1.1400Z2(b)-1(c)(3)-(4).
[58] 85 FR 1866, Part III.G.3.

investment, either instance being referred to as a "mixed fund investment".[59] In this situation, the funds from the sale or exchange would constitute a qualifying investment and the additional funds contributed to the Fund or funds to which an election is not made would be a non-qualifying investment.[60] If the decedent's investment in a Qualified Opportunity Fund exceeded the gain the decedent elected to defer under Section 1400Z-2(a), the investment is a mixed-funds investment that is treated as two separate investments–a qualifying investment subject to Section 1400Z-2, and a non-qualifying investment to which Section 1400Z-2 is inapplicable.[61]

Proposed Regulation Section 1.1400Z2(a)-1(b)(11)(i)(D) identified the basis of the non-qualifying investment as the taxpayer's total basis in the Qualified Opportunity Fund less the basis of the qualifying investment, in each case determined without the zero-basis rule and without any other basis adjustment provided for in Section 1400Z-2(b)(2)(B).[62] In practice, this amount equals the taxpayer's total investment in the Qualified Opportunity Fund less the amount of gain invested on which the capital gains tax was deferred. Because Section 1400Z-2 is inapplicable to the non-qualifying investment, the recipient's basis in the non-qualifying investment on the death of the owner is governed by Section 1014, which allows for a step-up in basis upon the death of the investor.[63]

EXAMPLE

> Assume Taxpayer A has Qualified Opportunity Zone Business Property with a basis of $1,000,000 that is sold for $2,000,000 on January 1, 2019. This creates taxable gain of $1,000,000 for Taxpayer A. If the $1,000,000 is reinvested by Taxpayer A in a Qualified Opportunity Fund within 180 days and stays invested, no tax will be due for the 2019 tax year.[64] Assume that Taxpayer A, in addition to

[59] I.R.C. § 1440Z-2(e)(1)
[60] *See generally* 85 FR 1866, Part III.G.3.
[61] I.R.C. § 1440Z-2(e)(1); 85 FR 1866, Part III.G.3.
[62] 85 FR 1866, Part III.G.3.
[63] *Id*.
[64] I.R.C. § 1400Z-2(a)(1)(A).

the $1,000,000 from the sale of the Qualified Opportunity Business Property, also contributes $1,000,000 in funds from another source.

Taxpayer A's investment constitutes a "mixed funds investment" under Section 1400Z-2(e)(1).[65] Taxpayer A's initial basis in the fund will be determined separately between the qualifying investment and the nonqualifying investment. Therefore, Taxpayer A's basis in the $1,000,000 qualifying investment is $0, in accordance with Section 1400Z-2(b)(2)(B)(i).[66] Taxpayer A's basis in the non-qualifying investment is $1,000,000, which is determined by taking the entire basis of the Qualified Opportunity Fund, $2,000,000, and subtracting the basis of the qualifying investment, $1,000,000, both numbers determined without regards to the zero-basis rule.[67] In summary, upon investing in the Qualified Opportunity Zone, Taxpayer A has a $0 basis in the qualifying investment and a $1,000,000 basis in the non-qualifying investment.

In year five, Taxpayer A receives a basis step-up for the qualifying investment equal to 10 percent of the original deferred gain amount, or $100,000.[68] The deferred gain is reduced by this same $100,000 amount.[69] Assume that the nonqualifying investment has appreciated to $1,500,000. If Taxpayer A dies in year six, Taxpayer A's beneficiaries will receive the qualifying investment with a basis of $100,000, as the beneficiaries step into the shoes of the original investor regarding a qualifying investment. The beneficiaries will receive the nonqualifying investment with a basis of $1,500,000, which reflects the $500,000 appreciation under Section 1014.[70]

As with other income in respect of a decedent ("IRD"), which is income earned by a decedent who was a cash basis taxpayer prior to his or her death but that is not properly includible in income until after the decedent's death, the estate tax value is not reduced by the liability for the deferred income tax when dealing with the non-qualifying investment.[71] One very significant aspect of IRD is that Section 1014(c) denies a step-up in bases at death to items of IRD.[72] Analogous to those rules relating to income in respect of a decedent is Section 691(b),

[65] I.R.C. § 1400Z-2(e)(1).
[66] I.R.C. § 1400Z-2(b)(2)(B)(i).
[67] I.R.C. § 1400Z-2(e)(1).
[68] I.R.C. § 1400Z-2(b)(2)(B)(iii).
[69] *Id*.
[70] I.R.C. § 1400Z-2(e)(1); I.R.C. § 1014(a)(1).
[71] 85 FR 1866, Part III.G.3.
[72] ACTEC Comment Letter at 4.

which addresses deductions and credits in respect of a decedent – which are incurred prior to death but are not properly allowable until after death.[73]

However, Section 1400Z-2(b)(2)(B), rather than Section 1014, applies with regard to the recipient's basis in the qualifying investment.[74] This Section provides that the basis of the qualifying investment is zero, with specified increases for gain recognized at the time of an inclusion event and for qualifying investments held for at least five or seven years.[75] Stated otherwise, and recalling the previous example, an investor's basis in a qualified investment begins at $0 and is adjusted upon holding the investment for five and seven years by a net 15 percent.[76] Consequently, if a qualified investment in a Qualified Opportunity Fund passes due to the death of an investor prior to a holding period of five years, the beneficiary of the interest will receive the interest in the Fund with a $0 basis. In addition, the basis of the qualifying investment in the Qualified Opportunity Fund receives an upward adjustment for any gain recognition that has not terminated the qualifying investment, such as recognition of the deferred gain amount no later than December 31, 2026. Accordingly, if the investment in the Fund experiences a basis adjustment prior to the interest passing to a beneficiary due to the death of the investor, such as the adjustments at a holding period of five and seven years or upon recognition of the deferred gain on or before December 31, 2026, the beneficiary will take the interest in the Fund with a basis equal to the amount of gain recognized. Simply put, the Regulations provide that a beneficiary's basis in a qualifying investment to which Section 1400Z-2 applies is the same as if the qualifying investment were held by the decedent investor.[77]

---

[73] *Id.*
[74] *Id.*
[75] *Id.*
[76] I.R.C. § 1400Z-2(b)(2)(B)(iii)-(iv).
[77] 85 FR 1866, Part II.A.3.D.5.

Further, interests received in a transfer by reason of death continue to be a qualifying investment in the hands of the beneficiary for purposes of Section 1400Z-2(c).[78] The implication of these clarifications is that the beneficiary is treated as a successor to the original eligible taxpayer investor.[79] Thus, the estate or the beneficiaries of the investment in the Qualified Opportunity Fund step into the shoes of the decedent investor and must continue to hold the investment for the relevant statutory periods or will have to pay tax on the deferred gain amount upon a sale, exchange, or disposition of the investment.[80] Additionally, the Final Regulations further made clear that an election to treat death as an inclusion event for liquidity concerns will not be provided.[81] This becomes increasingly important if the decedent investor has few other liquid assets included in his or her estate.

2. Implication of Tax Attributes of an Investment in a Qualified Opportunity Fund in the Hands of a Beneficiary

The significance in the tax attributes of an interest in a Qualified Opportunity Fund in the hands of a beneficiary when planning is within a potentially large tax liability in the upcoming years for the beneficiaries and liquidity concerns if the estate does not have many other liquid assets. Specifically, if an interest in a Fund passes due to the death of an investor before December 31, 2026, the beneficiary will be faced with a catch twenty-two of needing to continue to hold the investment to receive the tax benefits of Section 1400Z-2 due to the impending tax liability no later than December 31, 2026 and also needing to dispose of the investment in the case of an illiquid estate. This is where careful planning can protect the integrity of an investment in a Qualified Opportunity Fund by putting a beneficiary in a position where he or

[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *See supra* Note 41.

she does not need to sell the Fund to create liquidity and protect beneficiaries by removing an investment in a Fund from an estate all together as to mitigate or avoid liquidity concerns within an estate. The techniques that can accomplish these goals will be discussed at length below.

Now that the Regulations corresponding to Section 1400Z-2 have been finalized, the focus shifts from urging Treasury and the Internal Revenue Service to provide favorable and consistent treatment for Qualified Opportunity Funds as it relates to estate planning to how to effectively plan around an investment in a Qualified Opportunity Fund to protect the integrity of the Fund and the beneficiaries of the Fund. The various

II. PART II: PLANNING VEHICLE COMPARISONS

With the passage of the Final Regulations for Section 1400Z-2, it can now be readily determined where the existence of an interest in a Qualified Opportunity Fund would cause significant issues if the interest were to be included in the decedent investor's gross estate. Specifically, where an investor in a Qualified Opportunity Fund is at a higher risk of dying prior to December 31, 2026 and where the investor's estate would be foreseeably illiquid, the guidance provided by Treasury and the Internal Revenue Service should be utilized to plan around an interest in a Qualified Opportunity Fund to remove the investment from the investor's estate. In this Part, different planning vehicles or techniques will be discussed with particular emphasis on whether the technique solves the issue of illiquidity of an estate and whether the technique reasonably protects the Qualified Opportunity Fund and the beneficiaries of the Fund. In addition, each vehicle or planning device discussed herein will include the basic requirements of the vehicle to aid in understanding of where several of the vehicles can potentially cause an inclusion event and termination of a qualifying investment. As a general rule to keep in mind, an interest in a Qualified Opportunity Fund may be gifted or sold to a grantor or deemed grantor

trust or by transfer by reason of death without causing an inclusion event. While seemingly simple, which vehicle best serves the interests of each individual grantor is not without nuance.

A. GRANTOR OR DEEMED GRANTOR TRUSTS

As discussed in Part I, the Final Regulations specifically bless a gift or sale of an interest in a Qualified Opportunity Fund to a grantor or deemed grantor trust through application of the grantor trust rules. The rationale behind exempting these transactions between a grantor and a grantor or deemed grantor trust from the general rule under Section 1400Z-2 that any sale, exchange, or gift of an interest in a Qualified Opportunity Fund causes inclusion is perhaps an obvious one – for Federal income tax purposes, the owner of the grantor trust is treated as the owner of the trust's property and thus of the qualifying investment in the Qualified Opportunity Fund.[82] In its simplest of terms, a grantor trust is a trust in which the grantor retains one or more powers over the trust, causing the grantor to be treated as the owner of any portion of the trust.[83] Retaining these powers, as delineated in Section 671 through 679,[84] causes the trust income to be taxable to the grantor.[85]

Under Section 673(a), a trust will be a grantor trust if the grantor has a reversionary interest in either the trust principal or income that exceeds five percent of the value of such property.[86] Further, if a grantor retains certain administrative powers,[87] revocation powers[88] and/or income interests,[89] the trust will be deemed to be a grantor trust, even if the trust has an

[82] 85 FR 1866, Part II.A.5.
[83] *See generally* I.R.C. § 671.
[84] I.R.C. §§ 671-679.
[85] *Id*.
[86] I.R.C. § 673(a).
[87] I.R.C. § 675.
[88] I.R.C. § 676.
[89] I.R.C. § 677; These income powers generally include the power to, without consent of an adverse party, distribute income to the grantor or the grantor's spouse, hold or accumulate income for future distribution to the grantor or the grantor's spouse, or pay insurance premiums on the life of the grantor or the grantor's spouse with income from the trust.

independent trustee. In addition, a grantor is deemed to have the same powers and beneficial interests as the grantor's spouse,[90] any non-adverse party,[91] or any related or subordinate person.[92] Administrative powers typically used to trigger grantor trust status include the power to reacquire trust assets by substituting property of equivalent value[93] or the power to borrow without adequate interest or adequate security.[94]

While any one of the above mentioned powers retained by the grantor would cause a trust to be a grantor trust for income tax purposes and thus, for purposes of Section 1400Z-2, to qualify as an option to transfer an interest in a Fund without causing inclusion, best practices is always to retain multiple powers to the grantor. This concept of retaining more than one power for the grantor becomes especially important when an interest in a Qualified Opportunity Fund is contributed to a grantor trust. Although the Final Regulations specifically bless contributions of an interest in a Qualified Opportunity Fund to a grantor trust, if grantor trust status is terminated for income tax purposes for any reason, not only is there an inclusion event causing the tax on the deferred gain to become due, but the qualifying investment is terminated as the interest would have then been gifted or sold to a non-grantor trust. Termination of the qualifying investment results in the forfeiture of any and all income tax benefits remaining under Section 1400Z-2.[95]

---

[90] I.R.C. § 672(e).
[91] I.R.C. § 672(a)-(b); a non-adverse party is a defined term. Section 672(a) defines an "adverse party" as any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercised of the power which he possesses respecting the trust. Section 672(b) defined a "non-adverse party" as any person who is not an adverse party.
[92] I.R.C. § 672(c); I.R.C. § 1.672(c)-1; A related or subordinate person means any non-adverse party who is the grantor's spouse if living with the grantor; the grantor's father, mother, issue, brother, or sister, an employee of the grantor, a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control, or a subordinate employee of a corporation in which the grantor is an executive.
[93] I.R.C. § 675(4)(C).
[94] I.R.C. § 675(2).
[95] 85 FR 1866, Part II.A.5.

Additionally, and arguably most important for estate tax planning, while contributions of a Fund to a grantor trust by gift or sale are blessed by the Final Regulations, some of the powers under Sections 673-679 will cause estate tax inclusion under Sections 2036 and 2038. Section 2036 provides that any inter vivos transfer by a decedent made without a bona fide sale for full and adequate consideration under which the grantor has retained for any time period (1) the possession or enjoyment of, or the right to income from, the property,[96] or (2) the right either alone or in conjunction with any person to designate the persons who shall possess or enjoy the property or the income therefrom[97] shall be includible in the decedent's gross estate. Section 2038 provides that for transfers after June 22, 1936, except in the case of a bona fide sale, where the grantor retains the power to alter, amend, revoke, or terminate, or where such power is relinquished within the 3 year period ending on the date of the decedent's death, the value of all property subject to such power is includible in the gross estate of the taxpayer.[98]

Accordingly, for purposes of contributing an investment in a Qualified Opportunity Fund to a grantor or deemed grantor trust, an investor will want to retain powers that trigger grantor trust status without triggering estate tax inclusion. Specifically, to ensure that the value of a grantor trust is not includible for estate tax purposes under Section 2036 or 2038, a grantor will want to avoid retaining powers such a reversionary interest under Section 673, the power to revoke under Section 676, or an income interest under Section 677.[99] Consequently, a grantor or deemed grantor trust only serves as protection from illiquidity in an estate upon a grantor retaining specific powers under Sections 673-679, such as the power to substitute assets under

[96] I.R.C. § 2036(a)(1).
[97] I.R.C. § 2036(a)(2).
[98] *See* I.R.C. § 2038.
[99] *See* I.R.C. §§ 2036, 2038.

Section 675. Other powers retained under Sections 673-679 will cause inclusion for estate tax purposes and therefore, will not protect against an illiquid estate.

1. INTENTIONALLY DEFECTIVE GRANTOR TRUST

One effective vehicle to achieve grantor or deemed grantor trust status and to remove assets from a grantor's gross estate is an Intentionally Defective Irrevocable Trust or Intentionally Defective Grantor Trust ("IDITs or IDGTs"). IDGTs are irrevocable trusts that retain certain powers to the grantor under Sections 671-679 to give the grantor control over the assets of the trust.[100] IDGTs remove the trust assets from the grantor's taxable estate but retain the grantor as the owner of the trust for income tax purposes.[101] IDGTs are generally a favorable option for assets that are expected to appreciate rapidly as the asset is "frozen" to the value the asset held when it was transferred to the IDGT, either by sale or gift. Typically, grantors will choose to sell the assets to the IDGT to avoid gift tax liability or use of gift tax exemption. This is accomplished by selling the asset to the IDGT in exchange for a promissory note of a stated length, with enough interest to classify the trust as above market, but below the rate at which the assets are expected to appreciate. It is advisable for the grantor to pay the income tax liabilities of the IDGT to allow the trust assets to grow tax-free.

As discussed previously, although the general rule under Section 1400Z-2 is that any sale or exchange of an investment in a Qualified Opportunity Fund is an inclusion event and results in either partial or full termination of a qualifying investment in the Fund, a sale to an IDGT, as a grantor trust, will not cause inclusion.[102] Specifically, the Final Regulations provide that a

---

[100] *See e.g.*, Alistair M. Nevius, *Intentionally Defective Grantor Trusts*, Journal of Accountancy, November 2008, https://www.journalofaccountancy.com/issues/2008/nov/intentionally-defective-grantor-trusts.html; although irrevocable, IDGTs are treated as grantor trusts and accordingly, are blessed by Treasury and the Internal Revenue Service to hold an investment in a Qualified Opportunity Fund.
[101] *See e.g., Id*.
[102] *See generally* I.R.C. § 1.1400Z2(b)-1(c)(3)-(4).

contribution to a grantor trust by the deemed owner of the trust either by gift or any other type of transfer between the grantor and the grantor trust that is a nonrecognition event as a result of the grantor trust rules is not an inclusion event.[103] With application of the grantor trust rules, a sale to an IDGT does not cause an inclusion event as a sale to a grantor trust by the grantor is disregarded for Federal income tax purposes and consequently, for purposes of Section 1400Z-2.[104]

This provision of Section 1400Z-2, through application of the grantor trust rules, allows for an investor in a Qualified Opportunity Fund to take advantage of an installment sale method, as discussed above, to transfer his or her investment to an IDGT while both retaining interest payments from the installment sale and the estate and gift tax benefits of an IDGT. An installment sale to an IDGT usually consists of a combination of a gift and a sale to the IDGT.[105] The grantor would first gift cash to the IDGT in an amount typically equal to a 10 to 15 percent down payment for the appreciated assets that will be sold to the IDGT, in this instance, the interest in the Qualified Opportunity Fund.[106] The grantor would subsequently sell the interest in the Fund to the IDGT in exchange for the down payment amount and a promissory note in the amount of the purchase price.[107] The promissory note typically provides for installment payments over time and interest at the minimum required Internal Revenue Service interest rate or annual "interest only" payments as well as a "balloon" payment of principal at the end of the term.[108] As mentioned above, a sale to an IDGT is typically preferable over gifting as a sale will

[103] *See* I.R.C. § 1.1400Z2(b)-1(c)(5).
[104] *See* Rev. Rul. 85-13 (February 19, 1985).
[105] *See e.g.*, *Installment Sales to Intentionally Defective Grantor Trusts*, Blank Rome LLP (2007).
[106] *See Id*. at 1-2.
[107] *See Id*. at 1.
[108] *See Id*. at 2.

entitle the grantor to interest payments and will avoid gift tax liability or use of the grantor's gift tax exemption.

Although a sale to an IDGT is typically preferable, gifting an interest in a Fund is still an option under the Final Regulations.[109] If a grantor wishes to gift to an IDGT rather than sell, the remaining gift tax exemption of the grantor becomes an important aspect in determining whether the IDGT is a good fit for the grantor's overall situation. If a grantor has used all or most of his or her gift tax exemption,[110] a contribution of an interest in a Qualified Opportunity Fund to an IDGT by gift likely is not the best option for that grantor. Because both the gift tax rate and estate tax rate are 40 percent, if the grantor does not have any gift tax exemption remaining, the gift tax on the investment in the Fund is simply exchanging one tax for another of the same amount.[111]

As a reminder, the same powers that cause estate tax inclusion under Sections 671-679 for grantor trusts apply to IDGTs.[112] Consequently, a grantor of an IDGT will want to avoid reserving the powers delineated in Sections 673, 676, and 677 to avoid including an investment in a Qualified Opportunity Fund in the grantor's estate.[113] If the appropriate powers are not reserved to the grantor, neither the illiquidity of the grantor's estate and correspondingly, nor the tax liability to the grantor's beneficiaries will be avoided by a contribution of the investment in the Fund to an IDGT. However, with proper planning, an IDGT can be a useful vehicle to

[109] 85 FR 1866, Part III.G.3.
[110] The exemption amount for 2020 is $11,580,000, ignoring portability. *See What's New – Estate and Gift Tax*, Internal Revenue Service, https://www.irs.gov/businesses/small-businesses-self-employed/whats-new-estate-and-gift-tax.
[111] *See How do the Estate, Gift, and Generation-Skipping Transfer Taxes Work?*, Tax Policy Center Briefing Book, https://www.taxpolicycenter.org/briefing-book/how-do-estate-gift-and-generation-skipping-transfer-taxes-work *citing* I.R.C., 26 U.S.C. Subtitle B: Estate and Gift Taxes.
[112] *See* I.R.C. §§ 671-679.
[113] *See supra* notes 134-137 and accompanying text.

remove the asset from the grantor's gross estate, freeze the value of the Fund for estate tax purposes, and to consequently mitigate any issues with estate liquidity.

2. GRANTOR RETAINED ANNUITY TRUSTS

A Grantor Retained Annuity Trust ("GRAT") is an irrevocable[114] trust in which the grantor retains the right to receive a fixed annual dollar amount (the annuity) annually for a fixed term.[115] GRATs are typically treated as grantor trusts under Sections 673(a) and 677.[116] The annuity amount does not have to be an equal amount each year. It can be defined as a fixed initial amount, increased up to 20 percent in each subsequent year.[117] At the end of the term, any remaining property passes as provided in the trust, either outright to designated beneficiaries or in another trust for the beneficiaries' benefit.[118] If the grantor dies during the term, the entire value of the GRAT is included in the grantor's estate under Section 2036 and Section 2039.[119] If the grantor survives until the end of the annuity term, all of the trust principal will be excluded from the grantor's estate for estate tax purposes. Consequently, the success of a GRAT is contingent on the grantor surviving the set term.[120]

The transfer of property to a GRAT constitutes a gift equal to the total value of the property transferred to the trust, less the value of the retained annuity interest.[121] The value of the

---

[114] Although a GRAT is an irrevocable trust, GRAT assets can be substituted with assets of similar value, so the asset originally contributed is not irrevocable, the trust itself is. Thus, if the Qualified Opportunity Fund were to significantly change in value, the grantor could simply substitute the investment in the Qualified Opportunity Fund with an asset of similar value such as a note, which is more stable. *See e.g.*, Jerry Anderson, et. al., *Attempting to Protect the Value Accumulated in a GRAT*, The Private Client Reserve, U.S. Bank, 2016, https://privatewealth.usbank.com/pcrcp/pdfs/insights/attempting-to-protect-value-accumulated-in-grat.pdf.
[115] Thomas W. Abendroth, Charles D. Fox IV, *"L.O.V.E." The ABC's of Estate Planning Acronyms and Service Marks*, 2016. (*hereinafter* "L.O.V.E.")
[116] *See* Walter Q. Impert, *A Review of Grantor Trusts*, Real Property, Probate, and Trust Journal, Fall 2014, https://www.dorsey.com/~/media/Files/NewsResources/Publications/2014/11/A-Review-of-Grantor-Trusts_2014Fall5_Walter_Impert.
[117] L.O.V.E. at 9.
[118] *Id*. at 8.
[119] *Id*.
[120] *Id*.
[121] *Id*.

annuity interest is determined by utilizing the valuation tables under Section 7520 and the applicable interest rate for the month of the transfer.[122] The goal in a GRAT is to increase the value of the annuity interest and to reduce the value of the gift of the remainder interest.[123] For this reason, a lower Section 7520 rate is better.[124] The grantor of a GRAT is treated as making an immediate gift when the trust is funded, but the value of the gift is a fraction of the total value of the property because it represents a future benefit.[125] Therefore, if the grantor survives the annuity term, there is an opportunity for property to pass to the designated remaindermen at a reduced transfer value.[126]

Most GRATs provide that the annuity payout amount must be satisfied from trust principal to the extent trust income in a given year is insufficient.[127] The Internal Revenue Service has ruled privately that Section 677 applies where the annuity may be satisfied out of trust income or principal.[128] Therefore, virtually every GRAT should be treated as a grantor trust with respect to all trust income.[129] Accordingly, a GRAT may be funded with stock or partnership interests or real estate, and that asset can be paid back to the grantor to satisfy the annuity obligation without the distribution of the asset being treated as a sale.[130]

Because GRATs are nearly always treated as grantor trusts, GRATs are a potential planning vehicle for Qualified Opportunity Funds. GRATs are currently being used as a mechanism to pass the appreciation from a Qualified Opportunity Fund nearly gift tax free to the

[122] *Id*.
[123] *Id*. at 6.
[124] *Id*.
[125] *Id*. at 8.
[126] *Id*.
[127] *Id*. at 9.
[128] *Id*. citing Letter Ruling 9415012 (January 13, 1994).
[129] *Id*. at 9.
[130] *Id*.

grantor's beneficiaries.[131] Because the annuity interest retained by the grantor typically equals approximately the fair market value of the transferred asset, the transfer is nearly gift tax free.[132] If the asset in the GRAT appreciates beyond the required annuity payment to the grantor, the future appreciation passes to the grantor's remainder beneficiaries.[133]

While a GRAT may be an effective gift tax planning vehicle, it does not solve the estate tax issues presented under Section 1400Z-2 and the corresponding Regulations. If the grantor of a GRAT holding a Qualified Opportunity Fund passes before the end of the GRAT term, and assuming also before December 31, 2026, the exact same issues of liquidity and the beneficiaries being responsible for the taxes associated with the Fund are presented as the asset is included in the grantor's estate. For this reason, although contributions of a Qualified Opportunity Fund to a GRAT treated as a grantor trust are blessed by the Final Regulations, a GRAT is not an effective vehicle for estate planning purposes. If a grantor still wishes to invest his or her interest in a Qualified Opportunity Fund in a GRAT, assumedly for gift tax purposes or some motivation other than estate tax purposes, the grantor may wish to acquire life insurance in an amount adequate to cover the liquidity issues presented by the Fund, to cover the foreseeable taxes associated with the Fund, and at a length of at least ten years to cover past December 31, 2026.[134]

---

[131] *See e.g.*, David Herzig, *New Opportunity Zone Regulations Present Estate and Gift Tax Implications*, Forbes, May 2, 2019, https://www.forbes.com/sites/davidherzig/2019/05/02/new-opportunity-zone-regulations-present-estate-and-gift-tax-implications/#5a9468c0483d.
[132] *Id*.
[133] *Id*.
[134] *See e.g.*, Harold Unger, *Qualified Opportunity Zones: Tax Credit Incentives for Investors*, The Unger Company, LTD, December 16, 2018, https://www.ungerltd.com/blog/.

3. MAINTAINING GRANTOR TRUST STATUS FROM TIME OF INVESTMENT: NON-GRANTOR TRUSTS

As a corresponding point to grantor trusts as an effective vehicle to have a Qualified Opportunity Fund excluded from a decedent investor's estate, it bears repeating the importance of not effecting a change in grantor trust status, including from a non-grantor trust to a grantor trust. A non-grantor trust is a trust where the donor has contributed assets to the trust in which he or she has relinquished all control, and thus, the trust is taxed as a separate entity rather than to the donor.[135] The donor can neither be a beneficiary or a trustee.[136] Unlike a grantor trust, the donor gives up all powers to revoke, amend, or terminate the trust.[137] Because the donor relinquishes all control upon contribution to the non-grantor trust, the trust assets are not includible in the grantor's estate and any income tax is either paid by the trust or by the trust's beneficiaries upon distribution. The importance of non-grantor trusts to Qualified Opportunity Funds is where a Fund has been held by a non-grantor trust since investment in the Qualified Opportunity Zone. Regulation Section 1.1400Z2(b)-1(c)(5)(ii) not only provides that the termination of grantor trust status will terminate a qualifying investment, but the creation of grantor trust status will also reduce or terminate a qualifying investment.[138] While this is not a technique that can be adopted if the Qualified Opportunity Fund has not been held in a non-grantor trust from its inception, for the same reasons that it is important not to terminate grantor trust status, it is important to not create grantor trust status in a non-grantor trust holding a

[135] In essence, a non-grantor trust is an irrevocable trust in which a grantor has not retained any powers under Sections 671-679. *See* I.R.C. §§ 671-679.
[136] This is consistent with the donor not retaining an income interest under Section 677, or other powers typically given to a trustee that would result in the grantor being the deemed owner of the trust. *See* I.R.C. §§ 671-679.
[137] In other words, the donor does not reserve the right under Section 675. *See* I.R.C. § 675.
[138] I.R.C. § 1.1400Z2(b)-1(c)(5)(ii).

Qualified Opportunity Fund as such change in grantor trust status would reduce or terminate a qualifying investment.[139]

B. Life Insurance and Irrevocable Life Insurance Trusts

Although already mentioned while discussing GRATs as a vehicle to protect an investment in a Qualified Opportunity Fund, life insurance may be a good option to couple with almost any planning vehicle where liquidity would be an issue if an asset were included in an individual's estate. If a grantor is concerned about either his or her beneficiaries' ability to pay the foreseeable taxes associated with an interest in a Qualified Opportunity Fund if a grantor were to pass before December 31, 2026 or the estate taxes if the Fund were to be included in the grantor's estate for any reason, life insurance may be a good option to provide liquidity to pay any foreseeable taxes.

To determine the amount of life insurance that the investor in the Qualified Opportunity Fund should acquire, the investor should first determine whether it is merely the foreseeable tax on the investment that he or she would want to provide liquidity for or whether there is concern that the entire value of the Fund will be included in the investor's estate and will create liquidity issues regarding an estate tax. If the taxes due no later than December 31, 2026 are the main concern, the investor can simply determine the applicable amount needed by multiplying the deferred capital gain, decreased by basis adjustments, by the applicable capital gains rate. For example, if the deferred gain amount is $1,000,000, and the investor holds the investment for the full seven-years to receive a net 15 percent basis increase and corresponding deferred gain

[139] *Id*.; A conversion of a non-grantor trust to a grantor trust is, in this case, thankfully not as easy as conversion from grantor to non-grantor. To convert an irrevocable non-grantor trust to a grantor trust, typically, the trustee will need to either decant the trust, modify the trust, usually through court approval, or receive approval from all beneficiaries. *See* David L. Case, *Conversion from Non-Grantor to Grantor Trust: Tax Issues*, Estate Planning, Vol. 46 No. 2, February 2019; https://www.tblaw.com/wp-content/uploads/2019/03/FINAL-ARTICLE-PUBLICATION.pdf.

reduction, $850,000 will be subject to a capital gains taxable rate of 20 percent, assuming that the individual's taxable income exceeds $434,550 for the taxable year, to equal $170,000 in taxes due.[140] On the other hand, if the concern is the investor's estate being potentially subject to an estate tax if the Qualified Opportunity Fund, or any other assets for that matter, is included in the investor's estate, the investor will want to acquire life insurance in a greater amount than that to cover the foreseeable taxes on the Qualified Opportunity Fund and potentially in an amount to cover 40 percent of the value of the investor's gross estate over the applicable estate tax exemption.

There are obvious drawbacks from life insurance. If an investor is of an age where the likelihood of passing before December 31, 2026 is increased, the cost of the insurance needed will increase exponentially. Just as an approximate example, while a healthy 35-year-old man who buys a 20-year level term policy, which has a fixed annual premium, might pay $430 a year to secure a $500,000 death benefit, a healthy 65-year old man, might pay $7,300 a year for the same policy.[141] As the amount the investor needs increases, the cost of the policy also increases. Consequently, while life insurance may be able to create liquidity in the instance of an illiquid estate, the cost of the life insurance can be astronomical.

If life insurance is a favorable option for an investor in a Qualified Opportunity Fund, it is also advisable to have any insurance policy contributed to an Irrevocable Life Insurance Trust ("ILIT"). An ILIT is a trust in which an irrevocable gift of a life insurance policy is made by the irrevocable assignment of all of the incidents of ownership in one or

[140] *See Topic No. 409 Capital Gains and Losses*, Internal Revenue Service, https://www.irs.gov/taxtopics/tc409.
[141] *See e.g., Ultimate Guide to Retirement: How Much will Life Insurance Cost Me?*, CNN Money, https://money.cnn.com/retirement/guide/insurance_life.moneymag/index9.htm.

more life insurance policies to the trustee.[142] The ILIT can either be funded, containing assets other than life insurance policies, often used to produce income to pay the insurance premiums, or unfunded, which contains only life insurance premiums.[143] Typically, the insured, here the investor in the Qualified Opportunity Fund, pays the premiums in the ILIT if it is unfunded, either by direct gifts or by annual gifts to the trustee.[144]

Two of the major benefits of an ILIT are the removal of the insurance proceeds produced by the life insurance held by the ILIT out of the investor's and the investor's spouse's gross estates while allowing the investor to retain significant control over the policies.[145] In addition, the insurance proceeds can be used for the surviving spouse's health, education, maintenance, and support or for buying assets from the investor's estate without causing the insurance proceeds to be subject to estate tax liability.[146] Accordingly, the insurance proceeds from the ILIT create liquidity upon the death of the investor. It is important to note that an ILIT can be costly to form and if the investor dies within three years of the creation of the ILIT, the policies held in the trust can be included in the investor's estate under Section 2035.[147]

In addition to removing the insurance policies from the investor's gross estate, the investor will want to do so at the lowest gift tax cost. Under Section 2503(b), qualifying gifts to a

---

[142] *See* Zaritsky & Leimberg, *Tax Planning with Life Insurance: Analysis with Forms January 2020*, ¶ 5.03[1], Westlaw; https://1.next.westlaw.com/Document/I3d3cfe51c01311da8725eac5fdcb2c2d/View/FullText.html?navigationPath=Search%2Fv1%2Fresults%2Fnavigation%2Fi0ad73aa600000170a260c8666f86d924%3FNav%3DANALYTICAL%26fragmentIdentifier%3DI3d3cfe51c01311da8725eac5fdcb2c2d%26parentRank%3D0%26startIndex%3D1%26contextData%3D%2528sc.Search%2529%26transitionType%3DSearchItem&listSource=Search&listPageSource=d3e57e154e62ca06df3b9fb490f6e61c&list=ANALYTICAL&rank=11&sessionScopeId=9e5f9582915d21714b43b37e330f6b129624d3c1c94d85f77c0938d00f33f086&originationContext=Search%20Result&transitionType=SearchItem&contextData=%28sc.Search%29. (*hereinafter* "Tax Planning")
[143] *See Id*.
[144] *Id*.
[145] *Id*. at ¶ 5.03[2].
[146] *Id*.
[147] *Id*.

trust are permitted a $10,000 annual exclusion for gifts of a present interest.[148] A gift of an insurance policy in trust is a nonqualifying gift of a future interest, absent any provisions creating a present interest in one or more beneficiaries.[149] The problem presented is that insurance policies are not income producing assets and therefore, providing a trust beneficiary with a fixed income or annuity interest is not possible to create the present interest needed to obtain the annual exclusion.[150] Thus, the creation of the present interest needed for the annual exclusion is accomplished through providing the trust beneficiaries with a Crummey power.[151] Conservatively, a Crummey demand power should provide (i) notice; (ii) a reasonable time to exercise the power;[152] and (iii) a provision that a parent or a guardian can receive notice and exercise the power on behalf of a minor.[153] Stated otherwise, for purposes of qualifying for the annual gift tax exclusion, a present interest is created in beneficiaries where the beneficiaries are given a limited time to demand contributions to a trust, converting the beneficiary's future interest gift to a present interest. The number of available annual gift tax exclusions corresponds to the number of beneficiaries given the Crummey powers.[154]

In addition to ensuring that present interests are created for the beneficiaries of the ILIT for gift tax purposes, one of the most important decisions for a grantor of an ILIT is selection of the trustee. As a reminder, an ILIT is a trust in which an irrevocable gift of

---

[148] *Id*. at ¶ 5.03[3].
[149] *Id*.
[150] *Id*.; An annual exemption for the Generation-Skipping Transfer Tax is also available. *See* Tax Planning at ¶ 5.03[7][a].
[151] The concept of Crummey powers originates from *Crummey v. Commissioner*, 397 F2d 82 (9th Cir. 1968). In that case, the Court of Appeals for the Ninth Circuit stated that a demand power created a present interest, even in light that (1) the beneficiary was a minor who could not exercise the demand power without the appointment of a guardian, (2) no guardian was appointed and the power was never exercised, and (3) the power had a limited duration. For a more in-depth explanation of Crummey powers, *see* Tax Planning.
[152] In *Estate of Cristofani v. Commissioner*, 97 TC 74 (1991), the Tax Court held that a fifteen-day withdrawal period was sufficient time to exercise the demand power.
[153] *See Crummey v. Commissioner* (1968); PLR 80-04172.
[154] *See* Tax Planning at ¶ 5.03[3][e].

a life insurance policy is made by the irrevocable assignment of all of the incidents of ownership in one or more life insurance policies to the trustee.[155] Because the grantor must assign all incidents of ownership, the grantor should not be the trustee. Regulation Section 20.242-1(c)(4) provides that an insured grantor who serves as the trustee of a trust will be deemed to hold the trust's incident of ownership for purposes of estate taxation under Section 2042.[156] While Revenue Ruling 84-179[157] has relaxed this general rule, best practices is to have the grantor select a trustee for the ILIT other than himself or herself to protect the ILIT's status as being excluded from the grantor's gross estate. Since the grantor cannot be the trustee, the grantor also must not possess the power to remove the trustee or to himself or herself become the successor trustee.[158] Accordingly, with the proper provisions, an ILIT can be a useful planning vehicle for investors in a Qualified Opportunity Fund for whom an insurance policy is a good option to create liquidity to pay the foreseeable taxes associated with the investor's interest in the Fund while also removing the insurance proceeds from the investor's gross estate for estate tax purposes.

C. Utilizing the Investment in a Qualified Opportunity Fund as Collateral

While life insurance and ILITs may be effective at creating liquidity, both can be expensive. Another potential solution to a beneficiary's illiquidity and corresponding inability to afford the tax on the deferred gain from a Fund is to have the beneficiary use the Fund as collateral for a loan. Regulation Section 1.1400Z2(a)-1(b)(12)(ii) states that "provided that the

---

[155] *See supra* note 168.
[156] Tax Planning at ¶ 5.03[6][a].
[157] Rev. Rul. 84-179 provides that a decedent will not be deemed to possess personally incidents of ownership held in a fiduciary capacity where the following exists: (1) the insured's powers over the trust are not exercisable for the insured's personal benefit; (2) the insured has not transferred the policy or any consideration for purchasing or maintaining it to the trust from the insured's personal assets; and (3) the devolution of the trust powers on the insured is not part of a prearranged plan involving the participation of the insured. *See Id*.
[158] *See Id*. at ¶ 5.03[6][c].

eligible taxpayer[159] is the owner of the equity interest in the [Fund] for Federal income tax purposes, status as an eligible interest[160] is not impaired by using the interest as collateral for a loan, whether as part of a purchase-money borrowing or otherwise."[161]

Because a Fund is available to be used as collateral for a loan without jeopardizing the investment in the Fund, for investors that do not wish to purchase costly life insurance premiums to cover the tax on the deferred gain in the case that the beneficiaries of their estate or trust are ultimately responsible for the tax, this may be a better option. Additionally, this allows the beneficiary to decide at the time that the tax on the deferred gain becomes due whether or not he or she has the liquidity to pay the tax rather than the original investor needing to make the determination in his or her estate plan whether his or her beneficiaries may have the necessary liquidity. Importantly, obtaining a loan with an interest in a Qualified Opportunity Fund as collateral may not be an option for every interest in a Fund. For example, if a taxpayer's interest is in an entity, such as a Family Limited Partnership, with significant transfer restrictions or marketability issues, it may be difficult securing a loan based on that interest as collateral. Thus, while using an interest in a Fund as collateral for a loan to pay the tax liability on the deferred gain is a helpful method under the Regulations, this is a client and Fund specific option that may not be a viable choice for every investor depending on the type of investment in the Fund.

It is important to note that the above-mentioned vehicles can, and often should, be used together and not in isolation. For instance, an investor in a Qualified Opportunity Fund may wish

[159] An eligible taxpayer is a person that is required to report the recognition of gains during the taxable year under Federal income tax accounting principles. Thus, for example, eligible taxpayers include individuals; C corporations, partnerships, S corporations, trusts, and decedent estates. Because a beneficiary steps into the shoes of the decedent investor for Federal income tax purposes, he or she will qualify as an eligible taxpayer. *See* I.R.C. 6 1.1400Z2(a)-1(b)(13).
[160] An eligible interest in a [Fund] is an equity interest issued by the [Fund], including preferred stock or a partnership interest with special allocations. An eligible interest includes a pre-existing interest in an entity that becomes a Qualified Opportunity Fund. *See* I.R.C. § 1.1400Z2(a)-1(b)(12)(i).
[161] Treas. Reg. § 1.1400Z2(a)-1(b)(12)(ii).

to gift or sell his or her investment to an IDGT to have the investment in the Fund excluded from his or her gross estate. The same investor may wish to acquire a life insurance policy to cover any foreseeable estate tax liability and may also wish to have that policy held in an ILIT to ensure that the policy itself is excluded from the investor and the investor's spouse's gross estate. Although the investor plans to acquire life insurance to cover the estate tax liability, the investor may opt to have the beneficiary of the investment remain responsible for the tax on the deferred gain in the Fund rather than providing the necessary liquidity through additional life insurance. The investor may be more comfortable with this option as the tax liability on the deferred gain in the Fund can be covered by borrowing against the Fund if the beneficiary finds himself or herself in a position where liquidity is needed to pay the tax liability.

CONCLUSION

With the passage of the Final Regulations corresponding to Section 1400Z-2, it became clear the impact that the provisions of Section 1400Z-2 would have on estate planning. The clear goal of the Final Regulations was to maintain the integrity of Section 1400Z-2 and its restrictions, which in turn, presents issues both to a Qualified Opportunity Fund and the beneficiaries of a Fund upon an investor's death regarding liquidity, basis, continued deferment of the original gain, or, in the alternative, a potentially large tax liability in 2026. However, arguably the biggest concern for beneficiaries, liquidity, along with other concerns, can be alleviated through careful planning. Accordingly, when drafting an estate plan for an individual who also is an investor in a Qualified Opportunity Fund, it is important to analyze the overall situation of the client and the intended beneficiaries of the client's assets to determine the best solution for protecting both the beneficiaries and the Qualified Opportunity Fund in the situation that the investor passes before December 31, 2026.