while potentially maximizing financial gains.

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By Dwight Kay, Kiplinger Consumer News Service (TNS)

Historically, the practice of tax-smart investing has been a powerful strategy for real estate investors. Very simply, tax-smart investing targets leveraging various investment strategies and vehicles in order to potentially optimize returns while also minimizing tax liabilities.

When it comes to real estate investing, three of the most powerful tax-smart options include:

- Qualified opportunity zones (QOZs)

- Delaware statutory trusts (DSTs)

intergenerational wealth transfer.

How qualified opportunity zone funds work

One of the most overlooked tax-savvy investing vehicles is the qualified opportunity zone fund. QOZ funds were born out of the Tax Cuts and Jobs Act of 2017 and were designed to encourage long-term investments into low-income communities across the United States. QOZ funds invest in real property or operating businesses within an opportunity zone, typically a geographic region that has been designated as underserved or blighted. In some ways, QOZ funds can be considered a social investment designed to entice private capital to underserved communities.

Here are a couple of examples of how QOZ funds work:

- **Example No. 1:** Investors who receive capital gain income from the sale of any appreciated asset can reinvest this income within 180 days of the sale of the investment asset into a QOZ fund until the end of 2026 to successfully defer their capital gains taxes. That means investors don't owe the IRS a penny on that income until April 2027.
- **Example No. 2:** Investors can potentially receive an even bigger benefit with QOZs by holding their investment for at least 10 years and a day. After this hold period, they don't have to pay even a single penny in taxes on the profits they made over that 10-year span—no matter how large these profits are. As always, there are never any guarantees that a QOZ fund or any investment vehicle will appreciate in value.

What to beware of with QOZ funds: As great as QOZ funds sound, investors need to evaluate a project's true investment potential before considering the tax benefits, especially since investors are typically required to keep their money locked up for at least 10 years in order to enjoy the full tax benefit. Like any real estate investment, there is no guarantee for cash flow, distributions or appreciation, and such an

Delaware statutory trusts (DSTs) stand out as a tax-savvy choice for many investors. First, DSTs qualify as "like-kind" real estate for the purposes of a 1031 exchange. This alignment grants investors the opportunity to defer capital gains taxes upon selling an investment property. To realize the benefits, investors direct the proceeds from the sale of their property toward purchasing a DST to receive a beneficial interest in professionally managed, high-quality institutional real estate assets. For instance, think of a 300-unit multifamily building located in attractive, secondary markets such as Nashville, Raleigh-Durham, Charlotte or Denver.

Furthermore, DSTs may own properties leased by single tenants operating under long-term net leases, such as prominent companies like FedEx, Amazon or Walgreens.

Second, DSTs enable investors to potentially diversify their real estate holdings without triggering immediate tax liabilities. Because DSTs can include an entire portfolio of properties, investors can spread their investment across various assets, locations and industries to help reduce the risk associated with investing in a single property or market.

Third, DSTs can offer investors significant estate planning advantages by allowing investors to transfer ownership interests to heirs. One of the key tax advantages of passing real estate property to heirs is that those recipients benefit from a step-up in basis. This step-up in basis is much like hitting the reset button on a property's current market value. Furthermore, this step-up in value can represent a significant benefit for anyone who inherits a property that has seen even modest appreciation.

Risks associated with DSTs: DSTs contain the same risks that all real estate investing entails, such as ongoing vacancy, tenant bankruptcies, problematic tenants, economic downturns, physical damage and unexpected repairs. Bottom line: There are no guarantees in real estate.

Also, unlike stock shares and other liquid investments, which can be bought and sold

want to own institutional-quality real estate that may normally be out of reach. A real estate income fund's sponsor oversees all the fund's activities, including performing real estate review and analysis, underwriting and property management.

Real estate income funds also provide investors the potential for depreciation. This non-cash expense lowers the taxable income earned in the fund. This may hold significant benefits for investors in high-tax states such as California and New York.

In addition, investors can potentially receive interest deductions in real estate income funds by deducting interest expenses associated with a variety of components within the fund. These can include:

- **Mortgage interest.** Interest paid on loans or mortgages used to purchase, improve or refinance real estate properties within the fund.
- **Operating expenses.** Interest on loans used for operational expenses related to real estate, such as repairs, maintenance or renovations.
- **Development loans.** Interest incurred on loans for property development, construction or significant renovations within the fund.

In navigating the intricate landscape of real estate investing, embracing the nuances of tax-smart strategies is not just a choice, but a pivotal advantage. QOZs, DSTs and real estate funds are the trifecta of tax-savvy investment options.

Regardless of what vehicle real estate investors decide to pursue, it is important to always consult with their CPA or tax attorney prior to investing in any of these options, as well as to read each offering's private placement memorandum for a full discussion of the business plan and risk factors.

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