INVESTING IN QUALIFIED OPPORTUNITY ZONES: A NEW TAX ADVANTAGED INVESTMENT STRATEGY

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As a result of recent tax reform, Opportunity Zones have emerged as a way for distressed neighborhoods to attract needed real estate development and for investors in these projects to receive favorable tax treatment. Such investments could allow you to defer capital gains taxes until 2026, reduce the amount of taxes you owe by up to 15%, and pay no taxes on the fund's gains if you hold it for ten years.

On December 22, 2017 the Tax Cuts and Jobs Act created a new section of the tax code (26 U.S Code §1400Z) that provides tax incentives for investments in targeted areas of the US through investment vehicles called Qualified Opportunity Funds (QOF). To date almost 9,000 such tracts have been identified in all 50 states, The District of Columbia, and five U.S. territories. By investing into an QOF, investors can not only defer and reduce their existing capital gains tax liability, but also eliminate future capital gains tax on returns earned from the Opportunity Fund.

KEY ASPECTS OF THE OPPORTUNITY ZONE PROGRAM

Opportunity Zones, which are census tracts, nominated by governors and certified by the US Department of the Treasury, into which investors can invest in new projects intended to spur economic development in exchange for certain federal tax benefits.

Opportunity Funds, which are investment vehicles that invest at least 90% of their capital in Qualified Opportunity Zones. The fund model enables investors to pool their resources in Opportunity Zones, increasing the scale of capital going to investments selected by the manager.

To capture the potential tax benefits offered by a Qualified Opportunity Fund, an investor must invest the gains from a sale of a prior investment (i.e. real estate, stocks, bonds) into a QOF within 180 days of the sale of the investment. The investor only has to roll in the gain or profits from the sale of the investment, not the original principal of the investment. Only the taxable gains rolled over into an Opportunity Fund are eligible to receive tax incentives.

Investing in Opportunity Funds can provide three substantial potential tax advantages to investors:

- **Deferral of Capital Gain:** A tax deferral for any capital gains rolled over in the Opportunity Fund. The deferred gain would be recognized on the earlier of December 31, 2026 or the date on which the investment in the Fund is sold.
- **Reduction of the Capital Gains Tax Realized:** A step-up in basis for capital gains rolled into an Opportunity Fund. The basis of the original investment is increased by 10% if the investment is held by the taxpayer for a least 5 years, and by an additional 5% if held for at least 7 years. If by December 31, 2026 an investor has held an investment in an Opportunity Fund for 7 years, then the tax on the initially deferred gain is expected to be reduced by 15% or reduced by 10% if by then held for only five years.
- **No Tax on any Capital Gains from an Investment in Opportunity Fund:** In the case of any investment in an Opportunity Fund held by a taxpayer for at least 10 years, the basis of such property shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged. In short, after 10 years, thereafter there would be zero federal capital gains tax on profits from the sale of an investment in an Opportunity Fund.

EXAMPLE INVESTOR'S STEP-BY-STEP PROCESS

Below are the steps an investor would need to follow to reap the maximum benefits offered through the Qualified Opportunity Fund program.

1. **December 31, 2021: Invest in Opportunity Fund (Day 1)**
2. **April 15, 2022: Make election on your tax filing showing capital gain rollover into an Opportunity Fund**
3. **April 15, 2031: Pay deferred capital gains tax**
4. **December 31, 2032: Opportunity Fund now becomes eligible for tax-free sale (10-year hold)**

The biggest benefits of investing in an Opportunity Fund go to those who have a large capital gains tax bill to defer.

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