OPPORTUNITY ZONES

WHAT IS AN OPPORTUNITY ZONE?

- A new program under the Tax Cuts and Jobs Act (TCJA) that encourages investment in specific economically-distressed communities.
- Economically-distressed communities are selected by states and then approved by the IRS.

HOW DOES IT WORK?

- Taxpayers re-invest net gains from the sale of an appreciated asset in a Qualified Opportunity Fund (QOF).
- Upon investment in the QOF, the capital is invested into pre-designated Opportunity Zones.

POTENTIAL BENEFITS OF OPPORTUNITY ZONES

- Permanently exclude 10% of the originally invested gain from taxable income if the investment is held for 5 years *(5-year period must be met prior to December 31, 2026 or sale of QOF investment).*
- Permanently exclude an additional 5% of the originally invested gain from taxable income if the investment is held for 7 years *(7-year period must be met prior to December 31, 2026 or sale of QOF investment).*
- Permanently exclude post-acquisition appreciation in the QOF investment if the taxpayer holds their interest in the QOF for a minimum of 10 years.

WHO CAN BENEFIT

- A taxpayer who owns appreciated assets can sell the property and re-invest in a QOF.
- Capital must be re-invested within 180 days of the sale.
- An affirmative election is required to defer the gain.
- The taxpayer must re-invest only the amount of the net gain on the sale, not the full sale proceeds (unlike the "like kind exchange" rules which require the full sale proceeds to be invested).
- The sale of appreciated property must not be made to a related party.
- 90% of the assets held by the QOF must be Qualified Opportunity Zone property.
- The property must be held by the fund on the last day of the fund's taxable year and the last day of the first six-month period of the fund's taxable year.

HOW LONG CAN A TAXPAYER DEFER THE GAIN ON SALE?

- The earlier of:
  A) The date of the investment when the QOF is sold or exchanged; or
  B) December 31, 2026

HOW MUCH OF THE DEFERRED GAIN MUST BE RECOGNIZED?

- The lower of:
  A) The deferred gain; or
  B) The fair market value of the investment to date, minus the taxpayer's basis in the investment.

HOW CAN THE QUALIFIED OPPORTUNITY FUND INVEST?

- Business property
- Stock
- Partnership interest

BASIS CALCULATION

- Upon investment in the QOF, the taxpayer’s basis is $0, because the capital invested was unrecognized gain.
- Any additional amounts contributed, above the net gain, will be included in the taxpayer’s basis.
- If the investment is held for five years, the taxpayer’s basis will be increased by 10% of the original deferred gain.
- If the investment is held for a total of seven years, the taxpayer’s basis will be increased by an additional 5% of the original deferred gain.
- To receive these basis increases, investments in QOFs must be made by 2021 to receive the 10% increase to basis and by 2019 to receive the additional 5% increase to basis.

ILLUSTRATIVE EXAMPLE

Yr 1
- Property, with a basis of $600 is sold for $1,000, resulting in a capital gain of $400.

Yr 1
- Within 180 days, the $400 gain proceeds are re-invested in a qualified opportunity fund, temporarily deferring the tax on the gain.

Yr 5
- The taxpayer receives a 10% step up in basis for the original capital gain ($400 x 10% = $40).

Yr 7
- The taxpayer receives a 5% step up in basis for the original capital gain ($400 x 5% = $20).

DEC 31 2026
- Tax on the deferred gain minus basis is due. Tax is on $340 ($400 - $40 - $20).

Yr 10
- Taxpayer is allowed to exclude all tax associated with any gain on appreciation on the QOF investment.