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Qualified Opportunity Zones in Layman's Terms

SCHNEIDER DOWNS, TAX
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There has been a lot of buzz lately regarding Qualified Opportunity Zones (QOZ). This is a new tax incentive contained in and created by the Tax Cuts and Jobs Act, which was passed in December 2017. As an auditor listening to our tax experts talk about this topic, a lot of this discussion was foreign to me, so I thought that it made sense to cover some of the basics and provide links to some helpful resources.

The following are some of the basics:

1. An Opportunity Zone is a low-income/economically distressed community nominated by the state and certified by the Treasury Department. The QOZ program is designed to spur long-term private sector investments in these communities. The investments may receive preferential tax treatment for the investors if certain conditions are met.

2. Investors can defer tax on any prior capital gains invested in a Qualified Opportunity Fund (partnership or corporation set up for investing in QOZs) until the earlier date on which the investment is sold or exchanged, or December 31, 2026. If the QOZ is held on for longer than five years there is a 10% exclusion on the gain and 15% for investments held longer than seven years. If the investor holds on to the QOZ investment for 10 years or longer, the investor is eligible for an increase in basis of the investment equal to its fair market value on the date that the investment is sold or exchanged.

3. To defer a gain, a taxpayer has 180 days from the date of the sale or exchange of appreciated property to invest the capital gain into a QOZ fund. This program does not have a requirement to invest in like-kind property. Therefore, realized gains on the sale of stock can be invested into a QOZ fund.

An example of how this may look:

- January 1, 2019, an individual taxpayer sells stock that generates a capital gain of $500,000.

- March 31, 2019 (within 180 days), the taxpayer contributes the $500,000 capital gain into a Qualified Opportunity Fund (QOF), which invests the money into a QOZ property. At this point the investor has zero basis in her/his QOF investment.

- March 31, 2024 (five years later), the investor’s basis in the QOF increases to $50,000 (10%).

- March 31, 2026 (seven years later), the investor’s basis in the QOF increases to $75,000 (15%)

- December 31, 2027. the investor pays tax on the $425,000 of deferred gains and the basis in the QOF increases to $500,000.

- March 31, 2029 (10 years later), the investor sells investment for $750,000. There is not a taxable gain, as the basis is deemed to be fair market value (the sales price).

The above is a high level and general overview of the QOZ program. If you are considering an investment in a QOF, consult your tax advisor prior to doing so.

The following links are helpful resources if you are considering an investment in a QOF:

IRS Frequently Asked questions on Opportunity Zones:

https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions

Previous Schneider Downs *Our Thoughts On* Articles on QOZs

https://www.schneiderdowns.com/our-thoughts-on/real-estate/tax/investment-opportunity-zones-yield-significant-tax-benefits-part1

https://www.schneiderdowns.com/our-thoughts-on/irs/tax/tax-savings-avail-qualified-opp-zones-proposed-regs-issued

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