

Are There Still Benefits to Investing In A Qualified Opportunity Zone?

11.19.2020

Although many sources have only touted the benefits of investing in a Qualified Opportunity Zone (QOZ) if you had done so prior to December 31, 2019--the short answer is: yes! There are still benefits to investing in a QOZ.

Investing in a QOZ gives investors three separate tax benefits:

- Temporary deferral of tax on capital gains
- Reduction in some but not all tax on capital gains through increases to basis after five and/or seven years of holding your QOZ Funds
- Permanent exclusion from capital gains taxation of post-investment appreciation if held for 10 years

Say, for example, that on November 15, 2020, you happen to sell a capital asset and have \$100,000 in capital gains which normally would be subject to capital gains tax, and subsequently, on December 9, 2020, you invest all of the gains into a QOZ Fund. Through the unique rules in the QOZ world, your basis in the Fund will be \$0 whereas normally it would be \$100,000.

Consequently, the first benefit you receive for investing in the QOZ Fund is that you skip capital gains tax on the \$100,000 on your 2020 tax return. Five years after your original investment, however, your basis jumps to 10% of the gain you originally invested. In this case, your basis would increase to \$10,000.

Taking this example a step further, we note that on December 31, 2026, you must recognize some of the capital gains from your initial investment, even though you did not sell your interest in the QOZ Fund. Assuming that the 2026 fair market value of your units in the Fund is \$150,000, you would only recognize \$90,000 in gain, and pay roughly \$18,000 in taxes. This will also cause your basis in the Fund to increase to \$100,000.

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Using this same example again, let's say you sold your capital asset in November of 2019. By the December 31, 2026 deadline your basis would have increased twice (at the five-year and seven-year marks) to 15% of the original investment, or \$15,000. Essentially, had you invested funds in a QOZ in 2019, you would pay 1% less in taxes. While investing in a QOZ in 2020 or 2021 does not avail you to every potential tax benefit, it is still an incredible opportunity to avoid a significant portion of your capital gains tax.

To wrap up the example, if you were to sell your interest in the QOZ Fund for \$200,000 in 2031 and make an election to step up your basis from \$100,000 to \$200,000, you would have no tax gain to recognize on this sale. At the end of the day, you only pay 18% (20% of 90%) of your investment, which is deferred for 6 years, all while investing in your community. Had you not utilized the QOZ structure, you would have paid \$20,000 in tax in 2020 and another \$20,000 in 2031.

Like any federal tax credit program, the future and rules surrounding QOZs are in flux. Certain QOZ deadlines, such as the 180 days to invest capital gains, have been extended until December 31, 2020. Further, President-elect Biden's transition team has already indicated that, while there might be additional anti-abuse provisions implemented, the program will persist.

There is also a possibility that the program could be extended past the December 31, 2026 deadline, or that more areas of the country might be approved as Opportunity Zones to rehabilitate. Since the ever-changing economic and political climates will surely have an impact on QOZ administration, Bailey Glasser will continue to provide updates to keep our friends and clients of any impending changes.

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Practice Areas

Tax Planning & Strategy