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What you need to know about Opportunity Zones

In 2017, Congress passed a large tax bill that significantly altered current tax legislation. Many of these changes are beneficial for taxpayers, and the Opportunity Zone program falls in this camp.

What are Opportunity Zones?

The Opportunity Zone program was established by the Investing in Opportunity Act. Its primary goal is to help revitalize "economically-distressed communities" – aka Opportunity Zones.

Opportunity Zones are nominated by each state for consideration. The Secretary of the U.S. Treasury then certifies the nominations to add these areas to the list of Qualified Opportunity Zones.
While prior efforts to boost local economies have primarily relied on taxpayer funds, the Opportunity Zone program aims to encourage private investors through a series of tax incentives.

Where are Opportunity Zones Located?

Opportunity Zones are listed as individual census tracts. You can find the complete Qualified Opportunity Zone list via the government website or in the Federal Register at IRB Notice 2018-48. A map is also available.

While the list of Opportunity Zones is still growing, the current list includes zones in all 50 states, as well as the District of Columbia, and five U.S. territories (Puerto Rico, the Virgin Islands, Northern Mariana Islands, Guam, and American Samoa). Many states have a wide range of zones listed, and the entirety of Puerto Rico is included as a Qualified Opportunity Zone.

Once an area is designated as an Opportunity Zone, it retains that status for ten years.
To date, there are 8,700 Qualified Opportunity Zones on the list. This is approximately 12% of all census tracts located within the U.S. and its territories.

Qualified Opportunity Zone must meet certain income and/or geographic requirements outlined in U.S. Internal Revenue Code Section 45D(e).

What are the tax beneifts of Opportunity Zones?

All of the benefits offered by Opportunity Zone Funds pertain to capital gains tax incentives. More specifically, there are three ways to reduce taxes via Opportunity Zone investments:

1) Investors can defer taxes on capital gains by reinvesting these funds in a Qualified Opportunity Fund within 180 days.

2) If the Opportunity Fund investment is held for five years, investors are also eligible for a 10 percent step-up in basis on the reinvested capital gains. If the investment is held for seven years, the basis is increased by an additional 5 percent. Therefore, a total of 15 percent of the original gain may be excluded from taxation.

3) If the investment is held for at least ten years, a permanent exclusion applies to any gains accrued after the initial Opportunity Fund investment.

To take full advantage of tax incentives, investors should reinvest capital gains into a Qualified Opportunity Zone fund and then hold the investment for 10 years. However, if that's not possible or financially feasible, there are immediate tax savings incentives as well as additional long-term savings once the property is held for five or seven years.

How to Invest in an Opportunity Zone Fund

Investors may take advantage of the program by investing in an Opportunity Fund.

These funds are self-certified by U.S. partnerships and corporations that meet certain criteria.
For one, they must intend to invest at least 90% of their holdings into qualified Opportunity Zones.

In addition, only certain types of investments (called "Qualified Opportunity Zone property") qualify.
These include:

- Partnership interests in businesses that operate in a qualified Opportunity Zone.
- Stock ownership in businesses that conduct most or all of their operations within a qualified Opportunity Zone.
- Property such as real estate located within a qualified Opportunity Zone.

Further, the investment must relate to the construction of a new building or the substantial improvement of an existing one.If the latter, the improvement investment must be larger than the purchase price of the building itself.

Unlike similar programs, however, Opportunity Funds are self-certified. They are privately managed through the fund managers and their administrators. Opportunity Zones in general have a minimal amount of government oversight.

Also, there is no limit for Opportunity Zone investments, so each zone may grow according to the total invested capital.

Conclusion

While experts disagree about the long-term economic costs of Opportunity Zones, the tax savings for investors are clear: Opportunity Zones can help investors save a large sum through tax incentives as long as the criteria are met.

If you anticipate capital gains this tax year, contact our office for more information about Opportunity Zone Funds.

You may also be eligible for tax incentives if you realized capital gains in 2017 or 2018, even if you've already filed a tax return for either year. Contact our office for more information about amending your prior year return and deferring your tax liability – or even eliminating part of it completely via an investment in the Opportunity Zone program.

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