The Beginner's Guide to Opportunity Zones

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OpportunityDb
The Opportunity Zones Database

The Beginner's Guide to Opportunity Zone Investing

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The Opportunity Zone policy initiative is the biggest economic development program in U.S. history — and the tax incentive of a lifetime. This guide provides comprehensive information on how Opportunity Zones have the power to catalyze positive social impact, and how you can reap massive tax savings by investing in Qualified Opportunity Funds.

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The newly created Section 1400Z of the Internal Revenue Code defines "Qualified Opportunity Zones" as low-income census tracts that were nominated by state governors and certified by the U.S. Treasury as Qualified Opportunity Zones.

Chapter 4: What are Qualified Opportunity Funds?

A Qualified Opportunity Fund is any investment vehicle organized as a partnership or corporation for the purpose of investing in at least one Qualified Opportunity Zone. A Qualified Opportunity Fund must hold at least 90 percent of its assets in Qualified Opportunity Zone Property. Learn how to invest.

Appendix: How much money can Opportunity Zone investing save taxpayers?

In the appendix to this guide, several examples demonstrate the tax savings potential of investing in Opportunity Zones, and the resulting impact on investment returns.

Tax incentives for Qualified Opportunity Zone Funds

An investor who is subject to capital gains as the result of an asset sale can take advantage of the tax incentives of investing in a Qualified Opportunity Zone Fund, so long as the investment is made within 180 days of the recognition date.

Note 1: For investors who recognize a capital gain through a partnership Schedule K-1, the recognition date for the purposes of Opportunity Zone investing is the due date for the partnership's federal tax return, typically March 15 of the following year. For example: a partnership realizes a capital gain on September 1, 2020. The gain is reported on the partner's Schedule K-1 by March 15, 2021. The partner would have until September 11, 2021 (March 15 + 180 days) to re-invest his gains into a Qualified Opportunity Fund.

Note 2: In June 2020, the IRS issued Notice 2020-39, which extended the 180-day deadline to provide taxpayers affected by the coronavirus pandemic with additional relief.

The notice states that for any 180-day period that ends on or after April 1, 2020 and before December 31, 2020, the investment deadline is automatically extended to December 31, 2020.

The gain can come from any type of asset sale — typically real estate; publicly traded securities such as stocks, bonds, mutual funds, ETFs; the sale of a privately held business; collectibles; or crypto assets, including Bitcoin.

Taxpayers who rollover their capital gains into a Qualified Opportunity Fund can benefit from three tax benefits — deferral, reduction, and exclusion.

1. **Deferral** of capital gain recognition from the original investment until December 31, 2026.
2. **Reduction** of capital gain recognition from the original investment. The amount of capital gain recognized from the original investment is reduced by 10 percent after achieving a 5-year holding period, so long as the 5-year holding period is achieved by December 31, 2026. There was also a 7-year hold incentive that reduced capital gain recognition on the original gain by 15 percent, but this expired on December 31, 2019.
3. **Exclusion** of capital gain recognition on Qualified Opportunity Zone Property held for at least 10 years, so long as the gain from the Opportunity Zone investment is recognized by December 31, 2047.

How to invest in Qualified Opportunity Funds

Anyone with capital gains may invest in Opportunity Zone Funds. In practice, most Qualified Opportunity Funds that are raising money from outside investors have filed for an SEC exemption under Regulation D, Rule 506(b) or 506(c). As such, they have limited their offerings to accredited investors only. With some exceptions, an accredited investor is an individual with annual income of at least $200,000 (or $300,000 of joint income with spouse) over the last two years, or net worth exceeding $1 million (not including primary residence).

Investment minimums in most Qualified Opportunity Funds that are seeking outside investment are often in the 5- or 6-figure dollar range. Typical investment minimums can range from $25,000 to $100,000, with some funds requiring a minimum investment of $250,000, or even $1 million.

Hundreds of such funds exist, with varying investment strategies. A list of Opportunity Zone funds is available on OpportunityDb.com. In general, Qualified Opportunity Funds are private placement funds that do not trade publicly on an exchange. While hundreds of funds are available directly to accredited investors, many funds are available only through wirehouse or RIA platforms. And many thousands more are privately held funds that are not seeking capital from outside investors.

If you have your own real estate deal located in an Opportunity Zone or business that is capable of having a presence in an Opportunity Zone, you may wish to create your own self-funded Qualified Opportunity Fund. Visit OZPros.com for information about how you can get started with forming your own Qualified Opportunity Fund and/or Qualified Opportunity Zone Business.

Disclosure: The author of this guide has ownership in OZPros.com.

Chapter 1: Inequality in America and the promise of place-based policies

By most appearances, the economic recovery in the United States since the Great Recession of 2007-09 has been nothing short of phenomenal. By February 2020, unemployment had dropped to 3.5 percent, its lowest rate in decades. And prior to the coronavirus pandemic, U.S. GDP had been growing at 2-3 percent per year.

But if you look below the surface, it becomes clear that this growth is largely occuring only in a handful of the wealthiest communities in this country. The recovery from the coronavirus pandemic may only further exacerbate the unevenness.

Inequality in the United States… is it a problem?

So long as we have capitalism, we will have inequality. It's inherent in the system. And some inequality is not necessarily a bad thing. But at what point does inequality do more harm than good? And has the United States already passed an acceptable level of inequality? By just about any measure, inequality in the U.S. today is at its highest point in decades.

The share of the nation's wealth held by the top 1% is at its highest level since World War II. Over the past century, inequality in the U.S. peaked during the Roaring Twenties. Wartime economic policies and subsequent post-war expansion resulted in the Great

Compression: from 1937 to 1947, Roosevelt's New Deal policies helped raise the incomes of the poor and working class and lowered that of top earners.

But beginning in the late 1970s, these trends began to reverse. For roughly the past 40 years, economic inequality has been on the rise. The chart above presents the share of U.S. net personal wealth among the top 1% over the last 100 years.

The chart above further illustrates the Great Divergence that began at the end of the 1970s. For much of the 1970s, the top 1% of income earners in the U.S. earned roughly 11 percent of income, while the bottom 50% earned roughly 20 percent. Today's figures show almost a perfectly mirrored image: the top 1% earns 20 percent, while the bottom 50% earns about 13 percent.

Does a rising tide lift all boats?

There is little debate that economic inequality is growing. (Although its impact has been challenged by some.) But it could be argued that growing inequality would not matter so long as the rising economic tide were to lift all boats, so to speak. In other words, so long as people on the lowest rungs of the socioeconomic ladder were increasing their economic prosperity over time, growing inequality should be less concerning.

But is this the case?

An August 2018 study by the Pew Research Center finds that for most U.S. workers, inflation-adjusted wages have not moved in the last 40 years. And most wage gains have gone to the highest earners. (Although it should be noted that non-wage benefits such as employer-sponsored retirement plans and health insurance have increased more than wages over this period.)

Among the points made in the study:

- Since 2000, inflation-adjusted usual weekly wages have risen just 3 percent among workers in the lowest decile of earnings.
- Over this same time period, among people in the top decile of earnings, real wages have risen 15.7 percent.

So yes, to a certain extent, the rising economic tide has in fact lifted all boats. Even wage earners at the very bottom of the ladder have more purchasing power today than they did 18 years ago, albeit just 3 percent more.

Conversely, this study of sluggish and uneven wage growth is one more key factor behind widening inequality in the United States.

But why should we be concerned with inequality? At high enough levels, inequality can have very negative consequences for everyone. It can lead to reduced middle-class income growth and increased disparities in education, happiness, and health. And as Bill Gates points out, high levels of inequality can wreak havoc on economic incentives, and ultimately skew democracies toward powerful interests.

Has inequality in the United States reached a tipping point where it is doing more harm than good? Left unchecked, capitalism alone may not self-correct toward more equality. But Opportunity Zones may prove to be a tool that provides an **incentive** for private capital to flow into areas of high poverty.

The unevenness of the post-recession recovery

To help us further deal with the unevenness of the economic recovery that has followed the financial crisis of 2007-08, it is helpful to look at EIG's Distressed Communities Index and associated statistics that help define the economic vitality of communities around the country.

Based on Census Bureau data from 2011-15, EIG's DCI combines seven metrics to arrive at an assessment of community economic well-being.

1. Adults without a high school diploma
2. Poverty rate
3. Prime-age adults not in work
4. Housing vacancy rate
5. Median income ratio
6. Change in employment
7. Change in establishments

Based on the averages from these seven metrics, ZIP codes are divided equally into quintiles with these labels:

1. Top 20%: **Prosperous**
2. Next 20% **Comfortable**

3. Middle 20%: **Mid-Tier**
4. Next 20%: **At-Risk**
5. Bottom 20%: **Distressed**

Economically distressed communities (the bottom 20% of all ZIP codes in this index) are home to 52.3 million Americans, about 17 percent of the U.S. population. The South has a disproportionately high number of distressed communities according to the index.

Prosperous ZIP codes dominated the recovery. They contained 29 percent of the nation's jobs in 2011, but have been home to 52 percent of new jobs created in the following five years. Furthermore, Prosperous ZIP codes captured 57 percent of the national rise in business establishments from 2011-2015, nearly double their share of businesses in 2011.

Meanwhile, Distressed ZIP codes shed more than 17,000 businesses during the period.

Vacant row houses in Baltimore

Over the five-year period ending in 2015, the U.S. added 10.7 million jobs and 310,000 businesses. But that impressive growth was concentrated in Prosperous ZIP codes, 85 percent of which saw an increase in businesses during 2011-2015. Conversely, only 22 percent of Distressed communities saw an increase in businesses during that time period.

The health toll of the disparity is also striking. On average, those living in distressed communities will die five years sooner. And death as the result of mental and substance abuse disorders is 64 percent higher in Distressed counties than in Prosperous ones.

How are we to deal with the unevenness of economic growth in the United States? First, we need to answer a hard question: why are a small handful of places capturing all of the gains from the economy and getting all of the capital investment, while everywhere else is getting left behind?

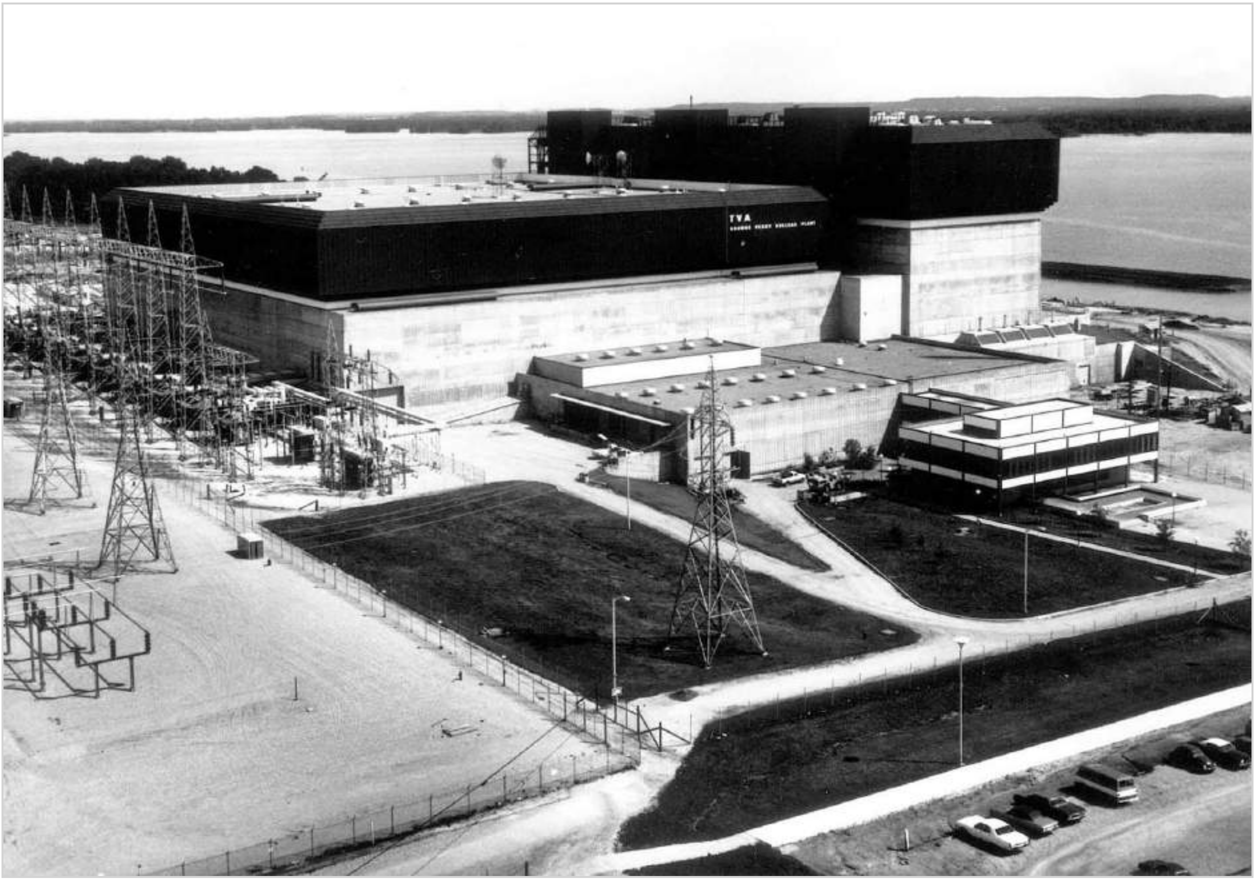
The promise of place-based economic development

Place-based economic development is based on the concept of economies of agglomeration, which considers that locations dense in jobs and people are more efficient and productive.

The Tennessee Valley Authority was formed in 1933 as part of Roosevelt's New Deal. It marks one of the federal government's earliest attempts at place-based policy-making. Its goal was to modernize the economy of the Tennessee Valley region with public infrastructure investment in hydroelectric dams, providing power for local manufacturing.

The most prominent form of place-based economic development in the United States prior to the enactment of the Opportunity Zone incentive was federal and state urban enterprise zones, sometimes referred to as empowerment zones. Established in 1994 under the Clinton administration, the Empowerment Zone Program created empowerment zones and enterprise zones. The New Markets Tax Credit (NMTC) Program that was formed as part of the Community Renewal Tax Relief Act of 2000 subsequently established renewal communities.

Under the NMTC program, local community development entities (CDEs) apply for allocation authority — the authority to raise a certain amount of tax-advantaged capital from investors. The NMTC program grants roughly $3.5 billion per year. The credit is 39% of the investment, and is paid out over the course of seven years, which results in about $1.365 billion in tax credits per year.



Tennessee Valley Authority power plant

These programs didn't just offer tax breaks for investors and businesses. They also poured government grants into communities to be spent on skills training and welfare-to-work initiatives.

Opportunity Zones are different in that there is no finite amount of government grant money to apply for. Nor is it a tax credit program.

Rather, the Opportunity Zone initiative creates a **powerful tax incentive** designed to spur private investment in low-income communities. It's entirely private-sector driven. Investors have far fewer hoops to jump through. And the pool of money being tapped is potentially enormous compared to the NMTC.

EIG estimated that [$6.1 trillion] in unrealized capital gains are eligible for preferential tax treatment under the Opportunity Zones initiative, as of year-end 2017. Officials at the

U.S. Treasury Department have estimated that this could be a $100 billion asset class. Compare that to the $3.5 billion NMTC program, and the difference in scale and the potential transformative effect become obvious.

A common criticism of the program is that it could amount to nothing more than a gentrification subsidy, as there are no community benefit requirements. State and city authorities will need to come in to counterbalance the temptation for investors to put their money in zones already on their way to gentrification. Local governments can use different tools to restrict the growth of undesirable businesses or too much luxury housing.

Conclusion

Inequality in the U.S. is worsening. But with the Opportunity Zone legislation passed as part of the Tax Cuts & Job Act, this imbalance has the potential to change. The Opportunity Zone initiative as defined in the Act creates an additional incentive for impact investing, allowing it to tap into a pool of approximately $6.1 trillion.

Chapter 2: The Investing in Opportunity Act

> *"It will be the biggest economic development program in U.S. history."*

So says Steve Glickman, co-founder and former CEO of the Economic Innovation Group, and one of the chief architects of the Investing in Opportunity Act.

Here's why Glickman is so optimistic: Among U.S. investors and corporations, approximately $6.1 trillion in unrealized capital gains is sitting on the sidelines, as of the end of 2017.

Additionally, hundreds of billions of dollars of capital gains *are* realized every year. In 2014 alone, Americans claimed $716 billion in realized capital gains on their tax returns.

The stock market selloff during February and March of 2020 was likely the biggest capital gain recognition period ever.

These are huge pools of money.

And it's these pools of money that the Investing in Opportunity Act (IIOA) — a modified version of which was passed in December 2017 as part of President Trump's Tax Cuts & Jobs Act (H.R.1) — was designed to tap into for the benefit of some of the most economically distressed areas of the nation.

It does so by defining **Qualified Opportunity Zones** and by creating an entirely new investment vehicle to invest in such zones — the **Qualified Opportunity Fund**. And by providing three huge tax incentives for capital gains deployment into these new funds.

The capital gains tax benefits are explained in more detail in Chapter 4: What are Qualified Opportunity Funds?

A brief history of the Investing in Opportunity Act

The Investing in Opportunity Act is bipartisan legislature, co-authored by Senators Tim Scott (R-SC) and Cory Booker (D-NJ) and Congressmen Pat Tiberi (R-OH) and Ron Kind (D-WI), and championed by nearly 100 congressional co-sponsors. It was initially introduced to both the Senate (S.293) and House (H.R.828) on February 2, 2017.

The Economic Innovation Group originally developed the idea in a white paper titled Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas, published in April 2015. The paper — authored by Jared Bernstein of the Center on Budget and Policy Priorities, and Kevin A. Hassett of the American Enterprise Institute — makes no mention of "Opportunity Zones" or "Qualified Opportunity Funds," but lays the groundwork for the preferential treatment of capital gains deployed to distressed areas of the country.

Senators Tim Scott (R-SC) and Cory Booker (D-NJ) were co-sponsors of the Investing in Opportunity Act.

The Investing in Opportunity Act encourages investment in economically distressed communities by offering three huge tax incentives, which are detailed in Chapter 4 of this guide.

What is a low-income community?

The intent of the Investing in Opportunity Act is to funnel investment into low-income communities that have been long overlooked. But, what is a low-income community exactly?

The legislation defines “Qualified Opportunity Zones” as low-income census tracts that were nominated by each state’s governor and subsequently certified by the U.S. Treasury as Qualified Opportunity Zones.

For purposes of defining an Opportunity Zone, the term “low-income community” takes its definition from Section 45D(e) of the IRS Code, which states that a population census tract, in general, is low-income if:

> *(A) the poverty rate for such tract is at least 20 percent, or*
>
> *(B) (i) in the case of a tract not located within a metropolitan area, the median family income for such tract does not exceed 80 percent of statewide median family income, or (ii) in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income.*

There are a few caveats to this definition that deal with targeted populations, areas not located within census tracts, low-population tracts, and high-migration rural communities, which are explained in more detail in the code.

Some contiguous non-low-income community census tracts that lie adjacent to low-income census tracts are also designated as Opportunity Zones.

What is a contiguous non-LIC census tract?

Certain non-low-income community (non-LIC) census tracts were able to be designated as Opportunity Zones if they were:

(A) … contiguous with the low-income community that is designated as a qualified opportunity zone, and

(B) the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tracts is contiguous.

But no more than 5 percent of a state's Opportunity Zones can be contiguous non-LIC tracts.

Qualified Opportunity Zone designations

The legislation called for the governors from all 50 states and U.S. territories, plus the mayor of Washington DC, to nominate Opportunity Zones from their jurisdictions. The governors could nominate up to 25 percent of their low-income census tracts.

An exception was made for states with fewer than 100 eligible tracts; these states were allowed up to 25 tracts to be designated as Opportunity Zones. Alaska, Delaware, the District of Columbia, Guam, Hawaii, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming were able to take advantage of this exception: they each have exactly 25 Opportunity Zones.

American Samoa, Northern Mariana Islands, and Virgin Islands each have fewer than 25 eligible census tracts. As a result, 100 percent of their eligible tracts were designated as Opportunity Zones.

Additionally, the 2018 Bipartisan Budget Act allowed for every low-income census tract and eligible non-LIC census tract in Puerto Rico to be certified as a Qualified Opportunity Zone. As a result, nearly the entire island of Puerto Rico lies within an Opportunity Zone.

The zone designations were finalized by the IRS in June 2018 and remain effective through the end of 2028.

More detail on Opportunity Zones can be found in Chapter 3.

Puerto Rico suffered massive damage from Hurricane Maria in 2017.

The creation of the Qualified Opportunity Fund

To receive the preferential tax treatment that Opportunity Zone investing offers, investments must flow through a newly created investment vehicle — the Qualified Opportunity Fund.

Opportunity Zone funds can be structured as corporations or partnerships. They must invest substantially in 1) Qualified Opportunity Zone Businesses (QOZBs) that hold Qualified Opportunity Zone Business Property (QOZBP), 2) Qualified Opportunity Zone Property (QOZP) directly, or 3) a combination of the two. In general, a Qualified Opportunity Fund must hold at least 90 percent of its assets in QOZBs or other QOZP.

Certain "sin" businesses (golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other facilities used for gambling, and liquor stores) are ineligible for investment.

More detail on Qualified Opportunity Funds can be found in Chapter 4.

Chapter 3: What are Opportunity Zones?

An Opportunity Zone is a low-income census tract that has been nominated by its state governor and certified by the Treasury Department. The nation's Opportunity Zones stand poised to receive a huge influx of investment, given the enormous tax incentives that the new legislation has created.

The Investing in Opportunity Act makes a big promise to these zones. But will the promises of economic growth (without too much resident displacement) come to fruition?

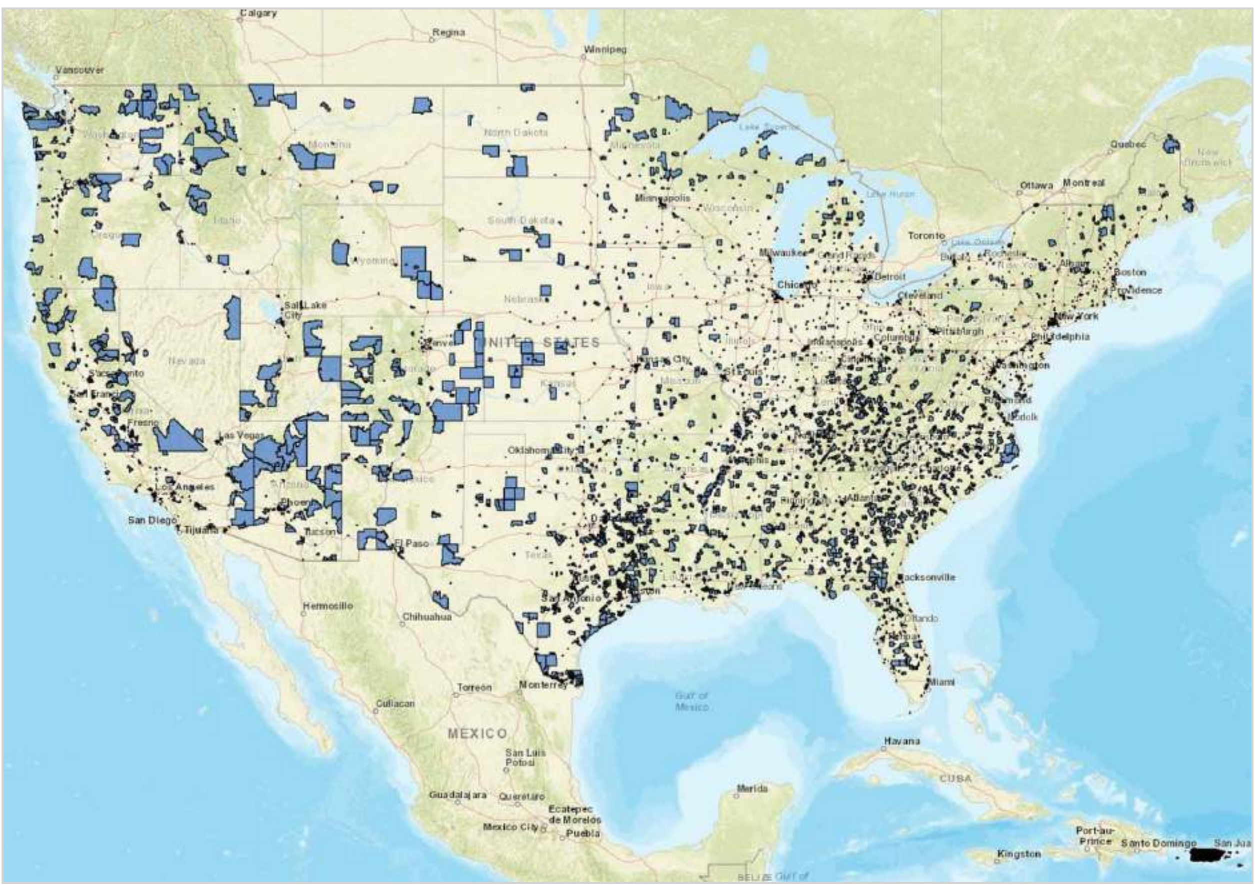
Opportunity Zone facts and figures

On June 14, 2018, the U.S. Treasury and IRS finalized certification of the Opportunity Zones. In total, 8,762 census tracts were certified as Qualified Opportunity Zones. These zones are located in all 50 states, the District of Columbia, and all five inhabited overseas territories. In December 2018, new data from the Census Bureau allowed for

[Puerto Rico to be granted two additional Opportunity Zones](), bringing the final total to 8,764.

A total of 8,534 out of 31,866 census tracts defined as low-income were designated as Opportunity Zones. An additional 230 eligible contiguous tracts (not defined as low-income) [were designated]() as well.

Nearly 35 million Americans live in these zones, per 2015 American Community Survey data. The average poverty rate in the Opportunity Zones is 32 percent, compared to 17 percent for the average census tract.



A total of 8,764 census tracts are certified as Qualified Opportunity Zones.

An interactive Opportunity Zone map is available at [OpportunityDb.com/map]()

Here's the breakdown by state:

LOCATION	DESIGNATED OPPORTUNITY ZONES	LOW-INCOME TRACTS	NON-LIC CONTIGUOUS TRACTS
Alabama	158	153	5
Alaska	25	25	0
American Samoa	16	16	0
Arizona	168	160	8
Arkansas	85	83	2
California	879	871	8
Colorado	126	119	7
Connecticut	72	71	1
Delaware	25	24	1
Florida	427	427	0
Georgia	260	260	0
Guam	25	23	2
Hawaii	25	23	2
Idaho	28	26	2
Illinois	327	327	0

Indiana	156	153	3
Iowa	62	61	1
Kansas	74	70	4
Kentucky	144	139	5
Louisiana	150	145	5
Maine	32	30	2
Maryland	149	145	4
Massachusetts	138	137	1
Michigan	288	283	5
Minnesota	128	127	1
Mississippi	100	95	5
Missouri	161	153	8
Montana	25	25	0
Nebraska	44	43	1
Nevada	61	60	1
New Hampshire	27	27	0
New Jersey	169	169	0
New Mexico	63	59	4

New York	514	497	17
North Carolina	252	241	11
North Dakota	25	25	0
Northern Mariana Islands	20	20	0
Ohio	320	317	3
Oklahoma	117	114	3
Oregon	86	81	5
Pennsylvania	300	289	11
Puerto Rico	863	837	26
Rhode Island	25	25	0
South Carolina	135	128	7
South Dakota	25	23	2
Tennessee	176	170	6
Texas	628	628	0
Utah	46	46	0
Vermont	25	23	2
Virgin Islands	14	13	1
Virginia	212	207	5

Washington	139	132	7
Washington DC	25	25	0
West Virginia	55	52	3
Wisconsin	120	120	0
Wyoming	25	24	1

Opportunity Zone ideals

By design, the Opportunity Zones program targets under-invested low-income communities on the margins — places where private investment would be highly catalytic. The very worst-off places in the nation are just not capable of attractive private investment. Conversely, communities already on an upswing would be a waste of program dollars.

As Annie Lowery puts it in The Atlantic, "Opportunity zones are meant to be Goldilocks-type places: not so distressed that no amount of government incentive would induce private money to them, not distressed but gentrifying and thus already seeing a flood of private money coming in."

How to invest in Opportunity Zones

Taxpayers wishing to invest in Opportunity Zones are required to deploy capital gains in Qualified Opportunity Funds. Such funds are structured as corporations or partnerships and invest in Qualified Opportunity Zone Property.

What is Qualified Opportunity Zone Property (QOZP)?

Qualified Opportunity Zone Property (QOZP) can be one of two things — 1) a Qualified Opportunity Zone Business (QOZB); or 2) Qualified Opportunity Zone Business Property (QOZBP). A QOZB can be structured as either a corporation or a partnership and must hold at least 90 percent of its assets in QOZP.

QOZBP is tangible property used in trade or business of a Qualified Opportunity Fund.

Qualified Opportunity Zone Property is explained in more detail in Chapter 4: What are Qualified Opportunity Funds?

Opportunity Zones vs. NMTC

Prior to Opportunity Zones, the most recent place-based economic policy was the New Markets Tax Credit (NMTC) program. Much of the Opportunity Zones regulatory language is borrowed from the NMTC program, but there are a few substantial differences.

Program Mechanics

Each program was developed to incentivize capital investment in under-invested areas of the country. But there are key differences in the mechanics of how this goal is achieved.

Under the NMTC program, a taxpayer invests cash in a special financial intermediary termed a Community Development Entity (CDE), which then invests in businesses within a zone. Each CDE must be pre-approved by the Treasury Department and is required to provide governance rights to community representatives.

Under the Opportunity Zones program, there is much less oversight. A taxpayer invests capital gains into Qualified Opportunity Funds, which then invests in businesses within a zone. But unlike CDEs, which must be pre-approved by Treasury, Opportunity Zone funds simply self-certify. There is zero pre-approval process, no community benefit requirement, and no requirement to provide governance rights to community representatives.

Tax Benefit

The tax benefit differs substantially as well. In the NMTC program, a dollar-for-dollar annual tax credit equal to the amount invested in a Community Development Entity (CDE) is granted to the taxpayer. But the taxpayer would still owe tax on any gains realized by the CDE.

The U.S. Treasury department oversees both the NMTC and OZ programs.

But under the Opportunity Zones incentive, investors can deploy capital gains from any asset into a Qualified Opportunity Fund. There are three tax benefits of this program: 1) deferral of capital gains tax until December 31, 2026; 2) reduction of capital gains tax due; 3) elimination of tax due on capital gains from Opportunity Zone investments.

Financial Impact

The NMTC allocates $3.5 billion in qualified equity investments annually. Conversely, the Opportunity Zones initiative has no limit to the amount of investment that can be made. Because of this, some believe that Opportunity Zones will dwarf the NMTC in terms of financial impact.

EIG's former CEO Steve Glickman has called the Opportunity Zones initiative "the biggest economic development program in U.S. history." And Treasury Secretary Steven Mnuchin believes there will be "over $100 billion of private capital" invested in Opportunity Zones.

Chapter 4: What are Qualified Opportunity Funds?

Qualified Opportunity Funds (QOFs) were created under the Investing in Opportunity Act, a version of which was passed as part of President Trump's Tax Cuts & Jobs Act of 2017. Per the IRS, QOFs self-certify using IRS Form 8996, with no approval process required. These new funds provide massive tax incentives for investing capital gains in some of America's most economically distressed communities.

Qualified Opportunity Funds defined

The U.S. tax code defines a **Qualified Opportunity Fund** as an investment vehicle that invests in **Qualified Opportunity Zone Property**. Specifically as follows:

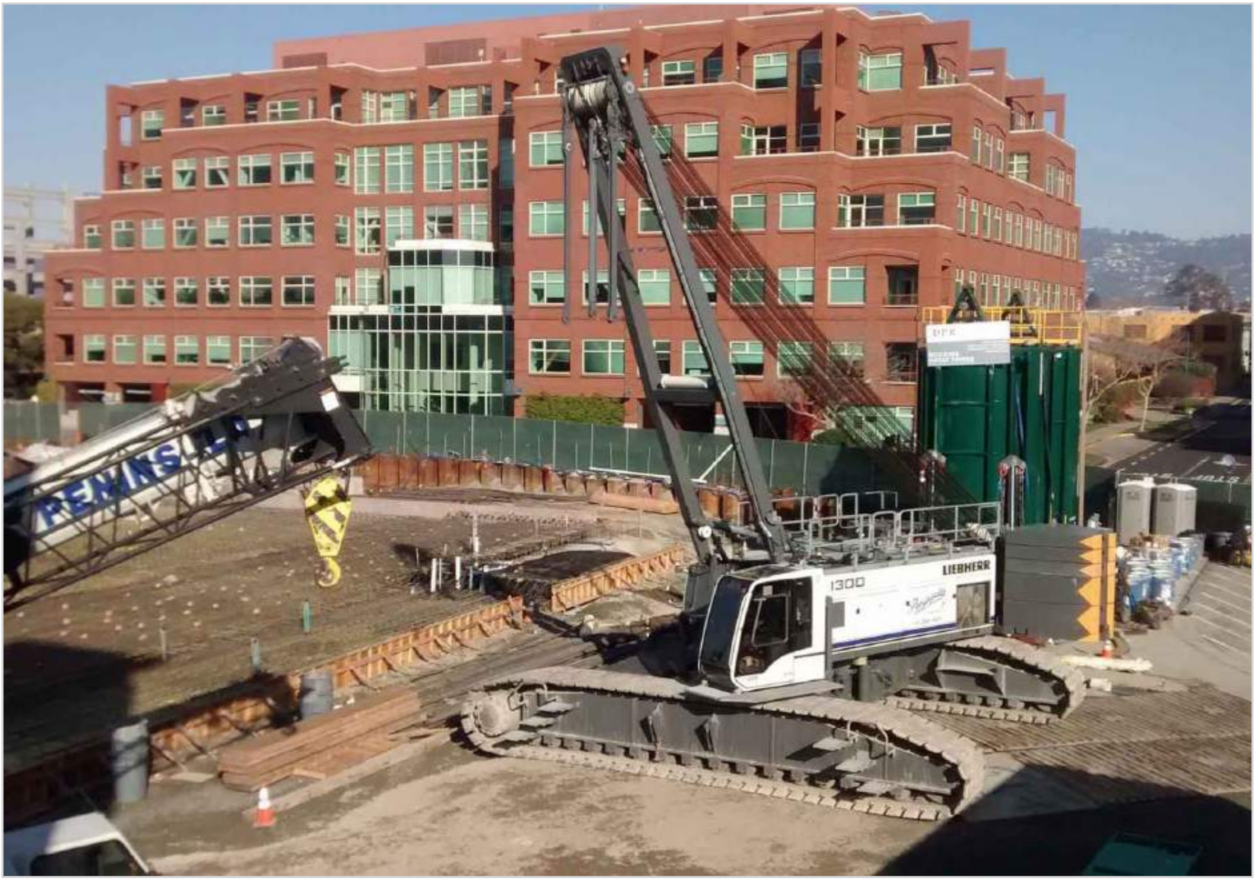
> *The term "qualified opportunity fund" means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured—(A) on the last day of the first 6-month period of the taxable year of the fund, and (B) on the last day of the taxable year of the fund.*

Opportunity Zone property can be either an **Opportunity Zone business** or **Opportunity Zone business property**. Put another way, a Qualified Opportunity Fund has two options:

1. It can invest in Opportunity Zone businesses that hold tangible property located within Opportunity Zones.
2. It can essentially become an Opportunity Zone business by investing directly in tangible property located within Opportunity Zones.

In practice, most Qualified Opportunity Funds opt for the first option, structuring such that the fund holds an underlying QOZB (or multiple QOZBs). The QOZB then holds the QOZBP property.

Let's now define these two terms — Qualified Opportunity Zone Business (QOZB) and Qualified Opportunity Zone Business Property (QOZBP).



Many expect Opportunity Zone funds to kickstart real estate development in previously under-invested areas.

Qualified Opportunity Zone Business (QOZB)

A QOZB can be either a corporation or partnership. In general, a QOZB is a trade or business in which substantially all of the tangible property of the business qualifies as follows:

- Such property was acquired by the business by purchase after December 31, 2017.
- The original use of such property in the Opportunity Zone commences with the QOZB, or the QOZB substantially improves the property.

- During substantially all of the QOZB's holding period for such property, substantially all of the use of such property was in an Opportunity Zone.

Furthermore, the QOZB must also adhere to the following criteria:

- At least 50 percent of the total gross income of the QOZB is derived from the active conduct of such business.
- A substantial portion of the intangible property of the QOZB is used in the active conduct of such business.
- Less than 5 percent of the average of the aggregate unadjusted bases of the property of a QOZB is attributable to nonqualified financial property.

And finally, the following types of "sin" businesses are ineligible to be deemed as a Qualified Opportunity Zone Business — private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or liquor stores.

Qualified Opportunity Zone Business Property (QOZBP)

QOZBP is tangible property used in a trade or business of a Qualified Opportunity Fund, so long as it meets the following three conditions:

1. Such property was acquired by the Qualified Opportunity Fund by purchase after December 31, 2017.
2. The original use of such property in the Opportunity Zone commences with the Qualified Opportunity Fund, or the fund substantially improves the property.
3. During substantially all of the Qualified Opportunity Fund's holding period for such property, substantially all of the use of such property was in an Opportunity Zone.

Tax advantages of Opportunity Zone investing

To encourage capital deployment to economically distressed Opportunity Zones, three tax advantages were created for capital gains invested in Qualified Opportunity Funds (QOFs).

1. Deferment of capital gains until December 31, 2026.
2. A step-up in basis of up to 15 percent on the original gain.
3. Elimination of capital gains accrued in the Qualified Opportunity Fund after a 10-year holding period.

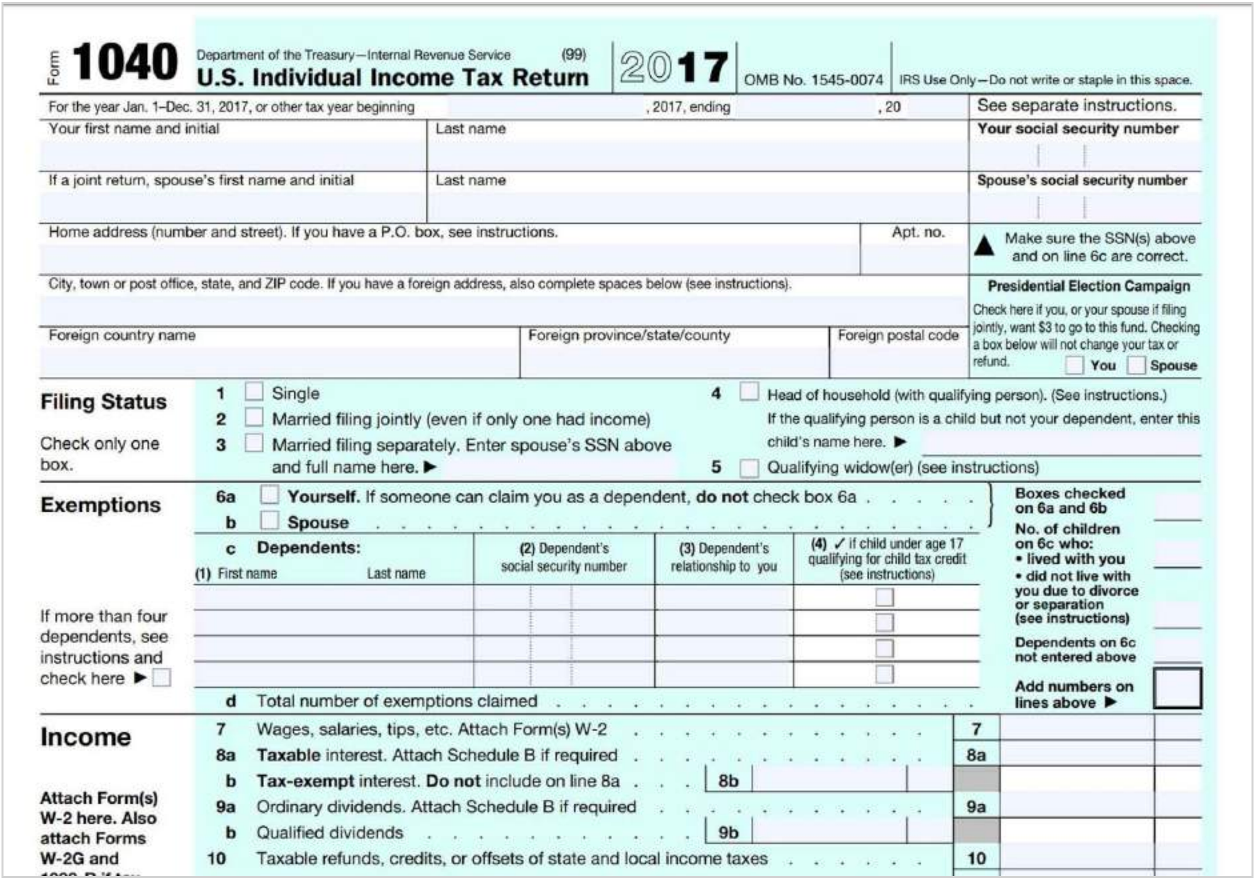
Advantage #1: Deferral of capital gain recognition until December 31, 2026

Any capital gains rolled into a QOF within 180 days will be tax deferred until December 31, 2026, or the date on which the Qualified Opportunity Fund investment is sold, whichever is earlier.

Advantage #2: Reduction in capital gains recognition

Capital gains rolled into a QOF within 180 days are eligible for a step-up in basis at year 5 and year 7. The basis of the original investment is stepped up by 10 percent after the QOF investment is held for 5 years, and by an additional 5 percent if the QOF is held for 7 years, so long as these milestones hit before December 31, 2026 (the date on which the original capital gain must be recognized).

If by December 31, 2026 the investor has held his QOF investment for 5 or 6 years, his capital gains on the original investment is effectively reduced by 10 percent.



Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2017** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20 See separate instructions.

Your first name and initial | Last name | Your social security number

If a joint return, spouse's first name and initial | Last name | Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | ▲ Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).

Foreign country name | Foreign province/state/county | Foreign postal code

Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. You Spouse

Filing Status
Check only one box.
1 Single
2 Married filing jointly (even if only one had income)
3 Married filing separately. Enter spouse's SSN above and full name here. ▶
4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 Qualifying widow(er) (see instructions)

Exemptions
6a **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b **Spouse**
c **Dependents:** (1) First name Last name | (2) Dependent's social security number | (3) Dependent's relationship to you | (4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
d Total number of exemptions claimed

If more than four dependents, see instructions and check here ▶

Boxes checked on 6a and 6b
No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above
Add numbers on lines above ▶

Income
Attach Form(s) W-2 here. Also attach Forms W-2G and
7 Wages, salaries, tips, etc. Attach Form(s) W-2 — 7
8a **Taxable** interest. Attach Schedule B if required — 8a
b **Tax-exempt** interest. **Do not** include on line 8a — 8b
9a Ordinary dividends. Attach Schedule B if required — 9a
b Qualified dividends — 9b
10 Taxable refunds, credits, or offsets of state and local income taxes — 10

Qualified Opportunity Fund investments offer three unique tax benefits to taxpayers.

If by December 31, 2026 the investor has held his QOF investment for 7 years or more, his capital gains on the original investment is effectively reduced by 15 percent. Note that this 15 percent is no longer achievable on an investment made after December 31, 2019. Likewise, the 10 percent benefit is set to expire on December 31, 2021.

The reduced capital gains tax payment would come due in April 2027. Of note is the fact that the 2026 tax rate would be applied. Tax rate risk is an issue to consider. Of course, if taxes on capital gains do increase between now and 2026, it would make the third advantage of Opportunity Zone investing just that much more powerful!

Advantage #3: No tax owed on capital gains from Qualified Opportunity Fund investments

This is by far the biggest benefit of the Opportunity Zones initiative, and the #1 reason why Treasury Secretary Steven Mnuchin expects more than $100 billion in investments to flow to Opportunity Zones as a result of the policy.

So long as a Qualified Opportunity Fund investment is held for at least 10 years, the basis of the investment will be adjusted to be equal to the fair market value of the investment on the date on which it is sold. In other words, there is zero capital gains tax due on any profits from the sale of an Opportunity Zone investment after a 10-year holding period.

Opportunity Zone fund vs. Section 1031 exchange

Savvy investors are familiar with 1031 exchanges. And Opportunity Zones appear similar at first glance. But there are a few substantial differences, summarized below.

Rollover

In a Section 1031 exchange, an investor must reinvest both the principal and capital gain within 180 days. And this transaction must be conducted through a qualified intermediary.

With an Opportunity Zone investment, an investor is only responsible for rolling over the capital gains within 180 days. The investor is not required to deploy the entire gain, but only the rolled over portion is eligible for tax advantages. Moreover, the principal can be used for anything. It does not need to be rolled over. And, placing an investment in a Qualified Opportunity Fund is much more straightforward, with no intermediary required.

Qualified assets

Only real estate gains are eligible for 1031 like-kind exchanges. Conversely, capital gains from any type of asset sale (real estate, stocks, bonds, etc.) can qualify for investment in a Qualified Opportunity Fund. Section 1231 gain is also eligible for investment in Qualified Opportunity Funds.

Investment structure

A Section 1031 exchange is structured to allow for single asset swaps, usually one real estate property for another real estate property. Multiple properties can be supported, but this option usually comes with higher costs and less flexibility.

On the other hand, Qualified Opportunity Funds can be either single-asset funds that invest in a single property or business, or multi-asset funds that invest in multiple properties across asset classes and geographies.

Capital gains tax deferral

Capital gains tax payments on a 1031 exchange can be deferred indefinitely. With Qualified Opportunity Funds, capital gains of the initial investment may be deferred until December 31, 2026.

Capital gains tax reduction

With 1031 exchanges, capital gains are reduced through a step-up in basis only upon death. With Qualified Opportunity Funds, the investor receives basis step-ups of 10 percent after 5 years and an additional 5 percent after 7 years, to account for a total available capital gains tax reduction of 15 percent. *Note: the ability to achieve a 15 percent basis step-up expired after December 31, 2019.*

Capital gains tax on final sale

With a 1031 exchange, the investor owes capital gains tax on final sale of the asset.

This may be the best benefit of investment in a Qualified Opportunity Fund: zero capital gains tax is due on any appreciation of the Qualified Opportunity Fund investment upon disposition, so long as the investment is held for at least 10 years.

Location, location, location

With a 1031 exchange, the investor's real estate can be located anywhere in the country.

Conversely, Qualified Opportunity Fund investments are limited largely to Qualified Opportunity Zone Property located in Opportunity Zones.

Forming a Qualified Opportunity Fund

Any entity that is taxed as a corporation or partnership can self-certify as a Qualified Opportunity Fund by completing IRS Form 8996. That part is easy.

Creating the organizing documents, compliance process, and audit trail can be challenging. Visit OZ Pros to learn more about how to create an Opportunity Zone fund.

Disclosure: The author of this guide has ownership in OZ Pros.

Appendix: How much money can Opportunity Zone investing save taxpayers?

Taking advantage of Opportunity Zone investing can save a taxpayer thousands or even millions of dollars on his tax bill, and result in higher ROI. Using our Qualified Opportunity Fund tax savings calculator, it's easy to see how powerful the incentive is to invest in Opportunity Zones.

To demonstrate the potential for tax savings and the impact that those savings may have on investment returns, let's look at a few different hypothetical examples.

Example #1: $100,000 capital gain invested in a Qualified Opportunity Fund doubles in value after 10-year holding period

In our first example, assume that The Investor realizes a $100,000 capital gain on his original investment. This could be from sale of any asset (stock, mutual fund, real estate, etc.). It doesn't matter where the gain came from.

On December 31, 2020, The Investor invests the $100,000 capital gain in a Qualified Opportunity Fund. By April 15, 2021, The Investor simply needs to make an election (using IRS Forms 8949 and 8997) on his tax return, showing that this $100,000 capital gain has been rolled over into a Qualified Opportunity Fund. So long as The Investor does not sell or exchange his share in the Qualified Opportunity Fund, his original $100,000 gain is not recognized until December 31, 2026.

In the meantime, his basis in the Opportunity Zone investment steps up by 10 percent on December 31, 2025, effectively reducing the amount of capital gain recognized on the initial investment by 10 percent, per Section 1400Z-2.

Note: A 7-year, 15-percent basis step-up benefit expired after December 31, 2019.

Tax on the original $100,000 gain is deferred until December 31, 2026. Therefore, on April 15, 2027, The Investor finally owes capital gains tax on the original gain. But because he has received a 10 percent step-up in basis on the Opportunity Zone investment, instead of paying capital gains tax on the full $100,000 amount, he is now only obligated to pay capital gains tax on $90,000.

Assuming a long-term capital gains tax rate of 23.8%, The Investor would have a tax bill of $21,420 due on April 15, 2027. Without the Opportunity Zone investment, The Investor would otherwise have owed $23,800 in capital gains tax on April 15, 2019. Effectively, The Investor has received a negative-interest loan from the federal government.

Furthermore, let's assume that after a 10-year holding period, the investment in the Qualified Opportunity Fund has doubled. The Investor's $100,000 share in the OZ fund is worth $200,000 when he sells it on December 31, 2030. Having held the QOF for at least 10 years, The Investor is now able to waive his entire gain for tax purposes. He owes 0 on the subsequent $100,000 gain.

Further still, without the ability to defer capital gains, The Investor would have only had after-tax dollars to invest. His $100,000 investment in Opportunity Zones would have instead been just $76,200 (assuming a 23.8% rate taken from the $100,000 gain on the original investment). The Opportunity Zone incentive effectively allows for The Investor to compound additional pre-tax dollars over many years before any liability comes due.

With Opportunity Zones: $100,000 gain from original investment is rolled over into a Qualified Opportunity Fund. Tax on $90,000 is paid in 2027. After 10 years, the Qualified Opportunity Fund investment doubles in value and is disposed of, for an additional gain of $100,000, on which no taxes are due. Total after-tax gain from the two investments comes to $178,580.

Without Opportunity Zones: $100,000 gain from original investment is taxed at a 23.8% rate. After tax, this amounts to $76,200. The $76,200 is reinvested and doubles in value over 10 years for a pre-tax gain of $76,200. After tax, this amounts to $58,064. Total after-tax gain from the two investments comes to $134,264.

In this example, The Investor has a significantly higher after-tax return in the Opportunity Zone investment.

Example #2: $100,000 capital gain invested in a Qualified Opportunity Fund doubles in value after 8-year holding period

In our first example, The Investor took full advantage of the Opportunity Zones tax incentive by holding his Qualified Opportunity Fund investment for a full 10 years. This allowed him to pay no tax on his subsequent $100,000 gain.

In our second example, let's make all of the same assumptions, except change The Investor's holding period from 10 years to 8 years. The Investor now sells his share in the Qualified Opportunity Fund on December 31, 2028 for $200,000.

The Investor still receives the 10 percent step-up in basis on the original investment and pays $21,420 in capital gains tax on April 15, 2027. However, since The Investor did not hold his Opportunity Zone investment for the full 10 years, he owes tax on any gain in the fund. In our example, this is a subsequent gain of $100,000. Therefore, The Investor would owe an additional $23,800 in capital gains tax on April 15, 2027, for a total amount owed of $45,220. He was still able to take advantage of several years of compounding pre-tax dollars, but his overall return is much less than in the first example.

Example #3: $100,000 capital gain invested in a Qualified Opportunity Fund loses value

Read about hypothetical Opportunity Zone investments just about anywhere, and they'll all assume that the Qualified Opportunity Fund will deliver a positive return. But investments do actually lose value sometimes! Let's assume that in our final example.

The Investor has a gain of $100,000 from his original investment. Within 180 days, he invests this $100,000 in a Qualified Opportunity Fund. He receives the 10 percent step-up in basis on his original investment before his deferred tax on the gains are due on April 15, 2027. He owes $21,420 on this date.

After a 10-year holding period (say, December 31, 2030), The Investor sells his Qualified Opportunity Fund shares for $50,000, thereby realizing a loss of $50,000. He would owe no tax and in fact can use this loss against his income for 2030.

Additional Resources

Did you enjoy this guide? You'll love these other Opportunity Zone resources!

- **Opportunity Zones Podcast** — New episodes every week featuring interviews with industry leaders guests, including legal and accounting professionals, fund issuers, policymakers, community development intermediaries, regulatory experts, impact investors, real estate developers, and more.
- **OZ Pros** — My advisory firm that can help you receive technical assistance in structuring and forming your own Qualified Opportunity Fund or Qualified Opportunity Zone Business, receive legal counsel, get your Opportunity Zone deal pitch ready, help with regulatory compliance, and much more.

- **List of Qualified Opportunity Funds** — A curated list of Opportunity Zone funds that are currently raising capital from investors. Use the filtering options to find a fund that may be right for you.
- **Opportunity Zones Map** — Is your real estate located in a Qualified Opportunity Zone? Find out by using this interactive map. Enter any address, or zoom in and pan around manually.
- **Opportunity Zone Tax Savings Calculator** — Enter a set of assumptions regarding cost basis, sale amount, and key dates along the way. Our calculator will estimate your tax savings from investing in a Qualified Opportunity Fund.
- **List of Opportunity Zones by State** — A complete list of all 8,764 census tracts designated as Qualified Opportunity Zones, listed by county and state. Includes demographic data.