



Tax Benefits of Opportunity Zone Funds



The American Families Plan proposes to increase tax rates for ordinary income and long-term capital gains. This has motivated investors to seek opportunities to defer and reduce capital gains tax where possible.

One type of investment that is increasing in popularity is an Opportunity Zone Fund which provides capital gain tax benefits, particularly for those who make an investment before December 31, 2021.

This document provides an overview of Qualified Opportunity Zones, Opportunity Zone Funds, and the tax benefits they provide.

What are Qualified Opportunity Zones & Opportunity Zone Funds?

Qualified Opportunity Zones are areas that the Internal Revenue Service has deemed to be “economically distressed communities” where new investments in property can provide investors with preferential tax treatment.

Opportunity Zone Funds are investment vehicles for the purpose of investing in Qualified Opportunity Zone properties. The objectives of an Opportunity Zone Fund are fairly straightforward: Communities in serious need of funding and development require assistance, and investors are incentivized to provide that assistance through the offering of preferential tax treatment on capital gains.



What are the potential tax benefits

Provided by the Tax Cuts and Jobs Act of 2017, Qualified Opportunity Zones enable an investor to defer capital gains and qualified 1231 gains by investing those gains into an Opportunity Zone Fund.

Timing is important. In order to defer the gain, it must be invested in the Opportunity Zone fund within 180 days of realizing the gain. Gains can then be deferred until December 31, 2026, unless the investment is sold or the fund is terminated.

In addition to the deferral of capital gains, the program provides the opportunity to decrease capital gains on the money invested into the fund.

If the investment is held for at least five years, then the basis of the investment is increased by 10% which reduces the taxable capital gain. For example, let's say that \$1 million of capital gains is invested into a fund in 2021. The investor has \$0 basis in the investment at that time. If the investment is then held for five years, until 2026, the investor receives a step up in basis of 10% which in this case would equate to \$100,000. Thus at the end of 2026, the investor would owe taxes on the difference, which would be \$900,000.

It's important to note that the capital gains deferral period ends on December 31, 2026 at which point the investor must realize this net taxable gain. This is why investors have until the end of 2021 to make an investment that qualifies for the step up in basis.

Opportunity Zone Funds also provide tax benefits on the appreciation of the investment in the fund. If the investment is held for ten years, then capital gains on the appreciation of the investment are eliminated.

Opportunity Zone Funds enable an investor to defer current capital gains until the end of 2026, decrease the taxes owed on the invested gains and eliminate gains on the appreciation of the investment.



How can you locate an Opportunity Zone Fund?

There are currently over 8,000 Qualified Opportunity Zones eligible for investment across the United States and U.S. territories, and the IRS maintains a public list of qualified zones on their website. Also, a list of active Opportunity Zone Funds is available online.

Are all Opportunity Zone Funds the same?

Although all Opportunity Zone Funds are conceived around the same principle and incentives, they should not be expected to produce uniform outcomes, nor are they immune to any number of potential risks.

It's important to remember that each Opportunity Zone Fund will have its own investment strategy, funding mechanism, and overall risk appetite. There are thousands of options, from funds dedicated to developing a single property to more diversified strategies that fund multiple developments across Qualified Opportunity Zones.

Because all of these zones have been designated as a result of their struggling economies, they all come packaged with heightened risk profiles. Therefore, it's critical to understand the unique risks associated with a particular zone or fund before investing.



Final Thoughts

The potential tax breaks on capital gains do not, by themselves, constitute a good reason for investment in an Opportunity Zone Fund. As with any significant financial decision, investing in Qualified Opportunity Zones requires careful evaluation and due diligence. If you would like to learn more about the tax benefits of Qualified Opportunity Zones, please call our office at any time.



About PBMares, LLP

PBMares, LLP is an accounting and business consulting firm serving U.S. and international clients, with offices in the Mid-Atlantic. The firm unlocks opportunity for clients using the right balance of industry, specialty and general business services in the areas of audit and accounting, tax planning and preparation, pension plan design/administration, and owner-managed/corporate financial consulting. In addition, the firm provides additional services through its affiliates: Artifice Forensic Financial Services, LLC, a financial consulting division specializing in fraud investigations and forensic accounting; PBMares Wealth Management, LLC, a registered investment advisor; and TMDG, LLC, a national healthcare consulting firm specializing in medical claims audits. More information is available online at www.pbmares.com.community-based initiatives.



PBMares, Headquarters
701 Town Center Dr.
Suite 900
Newport News, VA 23606



(757) 873-1587



pbmares@pbmares.com



www.pbmares.com

Baltimore | (443) 451-9010 Fairfax (Metro DC) | (703) 385-8577 Fredericksburg | (540) 371-3566
Harrisonburg | (540) 434-5975 Newport News | (757) 873-1587 Norfolk | (757) 627-4644
Richmond | (804) 323-0022 Rockville | (240) 499-2040 Warrenton | (540) 347-4970
Williamsburg | (757) 229-7180

