Holland & Hart

The Opportunity in Opportunity Zones

Insight — 03/05/2019

Holland & Hart

THE OPPORTUNITY IN OPPORTUNITY ZONES

Offering significant tax breaks for investors, the federal Qualified Opportunity Zone (QOZ) program is an intriguing prospect for real estate developers and investors. However, the Treasury Department is still formalizing the rules for these investments, creating a dilemma: buy now and save big on capital gains taxes, or wait to avoid unknown pitfalls?

The QOZ program was included by Congress in the Tax Cuts and Jobs Act of 2017 as an economic development tool to encourage investment in low-income urban and rural districts through a Qualified Opportunity Fund (QOF) with the goal of revitalizing troubled areas by spurring business development and creating jobs. Investors have a wide range of acceptable investments to choose from—everything from rehabilitation of existing structures, new construction, and startups.

As intriguing as the program is, how do you know if an investment is worth considering? Here are some pros and cons of investing in a QOZ.

THE PROS

1

Deferred and Reduced Taxes

The program allows investors to defer taxes on income from capital gains until December 31, 2026, if their capital gains are invested in a QOF within 180 days of realizing the gain. Taxes are discounted 10% after a five-year holding period, and an additional 5% at seven years if held for the applicable period until December 31, 2026. If the investor holds the investment for 10 years, there is no tax on the appreciation of the value of the investment when the interest in the QOF is sold.

THE CONS

1

The clock is ticking.

Because the deferral of capital gain lasts only through December 31, 2026, (or the sale of the interest in the QOF, if earlier), the value of the deferral goes down every day. This is also the last year investments will be able to meet the 7 year holding period to qualify for the full 15% exclusion of capital gains from taxation.