

OPPORTUNITY ZONES: POTENTIAL NEW BENEFITS FOR TAXPAYERS



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Opportunity zones, created as part of the Tax Cuts & Jobs Act of 2017, have proven to be a win-win for both investors and low-income communities. They provide tax incentives to investors and economically distressed communities with capital to spur economic development and create jobs. These benefits may become even more lucrative if the recently introduced Opportunity Zones Transparency, Extension and Improvement Act passes.

Original Incentives

An investor receives three main benefits with a qualified opportunity fund (QOF). The first is a deferral of capital gains taxes until the end of 2026. This includes both capital gains and qualified section 1231 gains, if the gains are not from a transaction with a related person and are timely invested into a QOF.

For example, one can take the capital gain from the sale of stock and invest in real estate, and still be eligible to defer the gain. Timely invested means you have 180 days to invest an eligible gain. For individuals with eligible gains, the 180-day period begins on the date of sale or exchange. Entities with eligible gains can elect to begin the 180-day period on the last date of their tax year, or the due date of the entity's tax return.

The second benefit is a tax liability reduction. The taxpayer can receive a 10% step up in basis if the investment is held for five years, and an additional 5% step up in basis if held for at least seven years. The capital gain tax deferral is only available until the end of 2026. In order to receive the benefit by the end of

the 2026 tax year, the investment must have been made by 2021 to receive the 10% step up, and by 2019 to receive the 15% step up.

The third and most important benefit is a tax exemption on the subsequent investment made through a QOF. If one holds this investment for at least 10 years, the investor receives a step up in basis equal to the fair market value of the investment on the date of sale. Any capital gains resulting from the sale of the QOF property will be tax-free.

New Incentives

In April 2022, the Opportunity Zones Transparency, Extension and Improvement Act was introduced. The bill would extend the investment deadline to December 31, 2028, and offer investors an additional two-year period to invest funds into a QOF and receive the opportunity zone capital gains tax benefit.

Another important update considers the holding periods to receive the tax liability reduction, the deadlines for which have passed. The holding period required for the full 15% step up would drop from seven to six years. Therefore, when combined with the extension to 12/31/2028, an investment made in 2022 would be eligible for the full 15% step up in basis, while those made in 2023 would be eligible for the 10% step up in basis.

If you expect large capital gains in 2022, pay close attention to updates on this proposed legislation. The chance to invest in these opportunity zones is still there, and along with it, the potential for tax savings.