Larson Gross
CPAs & Consultants

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 Larson Gross

Ted Larson and Dennis Gross founded our firm in 1949. They built the business based on excellence, passion, integrity, trust and pro-action — values still important to us more than seven decades later.

Even well into their retirement years, Ted Larson and Dennis Gross continued to have the best interest of the firm at heart. Mr. Larson would come into the office on a regular basis to meet every new face and make a personal connection with each of our team members. He remembered the name of every employee, as well as the names of their spouses and children, and would greet clients by name as he passed by the reception desk. Sometimes, you'd even find a newspaper clipping on your desk that Mr. Larson dropped off, highlighting that your son made the honor roll. This is the example of a genuine relationship we strive to embody with our people and clients.

Today, we're led by ten partners who are growing our firm with respect for where we've come from and a new vision for future success. Our 120-plus team members and three offices located in Bellingham, Lynden and Burlington make us the 10th largest public accounting firm in the Puget Sound region. While we're determined to expand our impact and help strengthen as many businesses and individuals as we can, we're also committed to remaining a locally-owned organization. We're incredibly proud of where we've come from and look forward to a future of possibility

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