



# Qualified Opportunity Zone Program

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The Qualified Opportunity Zone program was established by the 2017 Tax Cuts and Jobs Act to provide a tax incentive for private, long-term investment in economically depressed communities around the U.S. Investors can defer and potentially reduce taxes to be paid on recognized capital gains if they hold their investment in a Qualified Opportunity Fund for 10 years. When structured properly, any appreciation in the Qualified Opportunity Fund is also fully exempt from federal income tax.

As we enter the third quarter of 2022, it is an opportune time to revisit the incentives the program offers and how they may represent a great opportunity for the right investor.

## Tax Benefits of the Qualified Opportunity Zone program

Since 2017, the Qualified Opportunity Zone (QOZ) program has provided potential tax benefits in three different ways:

### Tax deferral

Any capital gains invested in a Qualified Opportunity Fund within the 180-day reinvestment period will not be recognized until the earlier of December 31, 2026, or when an inclusion event occurs (should the fund be partially or fully sold, or exchanged).

### Partial exemption from tax on 'original' capital gain

Should a Qualified Opportunity Fund be used to defer taxation on gains, 10% of those deferred gains will be permanently excluded from tax if the investment in the Qualified Opportunity Fund is held for five consecutive years before Dec. 31, 2026. The exclusion can increase to 15% if the investment is held for seven years before Dec. 31, 2026.

### No taxation on appreciation

If the investor holds the Qualified Opportunity Fund for at least 10 years, growth within the fund will be fully exempt from Federal income tax. It is important to note that the initial capital gains used to invest in the fund will be taxed by December 31, 2026, regardless.

One can potentially extend the 180-day reinvestment period mentioned above by leveraging the special rules which apply to pass-through entities such as partnerships. Here, two things could happen. First, the partnership can elect to defer all or part of a capital gain, and the 180-day period would start when the gain is realized. Deferred gains will not be included in the share of distributable income to the partners.

Should the entity decide not to defer any gain, the partner can decide to do so for his or her distributable share of the gain. This is a great opportunity to delay the beginning of the 180-day period, since the investor can choose to have the clock begin on the last day of the partnership's taxable year, on the entity's tax return due date (not including extensions) or on the trading date which generated the gain.

## Investing in the Qualified Opportunity Zone program in 2022

### The December 31, 2021 deadline

Because the tax deferral runs through the end of 2026, the deadline to be able to qualify for the 10% or 15% partial exemption was December 31, 2021. Any fund purchased after that date will not be eligible for the benefit as it cannot be held for five to seven years prior to taxation being assessed on December 31, 2026, so this is something investors will need to consider in 2022 and moving forward when deciding whether a QOF is relevant to them.

### Focusing on the remaining benefits

Despite the partial gain exclusion not being available to new QOZ investors, those who take advantage of the program in 2022 and beyond will be able to leverage the two other major tax benefits it offers, which are tax deferral and the absence of taxation on appreciation of the asset. Most of the savings that the QOZ program provides comes from these two points, making the partial gain exclusion fairly negligible for the long-term investor and making investing in a QOF a very relevant option in 2022.

### The potential for new regulations

The Qualified Opportunity Zone program recently received some renewed attention from legislators with the introduction of the Opportunity Zones Transparency, Extension, and Improvement Act on April 7, 2022. If passed into law, this bipartisan Act would increase reporting and monitoring requirements as well as qualify additional, new QOZ census tracts. Most importantly, it would provide additional and renewed tax incentives for investors.

The Act would extend the tax deferral period from December 31, 2026 to December 31, 2028, as well as reduce the holding period requirement for the 15% step-up in cost basis to six years, down from seven years currently. The changes would apply retroactively to investments in QOFs made after December 22, 2017. If passed into law, these proposed changes would make the QOZ program even more attractive for existing and prospective investors.

On the topic of new legislation, and when it comes to tax deferral, one also needs to consider the possibility that capital gains tax rates may be higher in the years leading to 2026 and beyond, depending on potential new tax laws. We encourage you to talk to your tax counselor to best assess your personal situation regarding this potential strategy.

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