The Beginner's Guide to Opportunity Zones

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The Opportunity Zones Database

The Beginner's Guide to Investing in Opportunity Zones

New to Opportunity Zones? This guide provides comprehensive information on Opportunity Zones and how to invest in Qualified Opportunity Zone Funds. If you are interested in creating a positive social impact and seeking the incredible capital gains tax advantages that the OZ incentive offers, keep reading.

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How the rise of inequality in America paved the way for several place-based policies over the years, leading to the Investing in Opportunity Act, which was passed as part of the Tax Cuts & Jobs Act of 2017.

Chapter 2: The Investing in Opportunity Act

The Investing in Opportunity Act is the legislation that defines Internal Revenue Code Section 1400Z, otherwise known as the Opportunity Zones tax incentive. The intent of the program is to spur private capital investment into under-invested, economically distressed communities.

Chapter 3: What are opportunity zones?

Section 1400Z of the Internal Revenue Code defines "Qualified Opportunity Zones" as low-income census tracts that were nominated by state governors and certified by the U.S. Treasury as qualified opportunity zones.

Chapter 4: What are qualified opportunity funds?

A qualified opportunity fund is any investment vehicle organized as a partnership or corporation for the purpose of investing in one or more qualified opportunity zones. An

opportunity zone fund must hold at least 90 percent of its assets in qualified opportunity zone property.

Appendix: How much money can opportunity zone investing save taxpayers?

In the appendix to this guide, several examples demonstrate the tax savings potential of investing in Opportunity Zones.

Tax incentives for Qualified Opportunity Zone Funds

An investor who is subject to capital gains as the result of an asset sale can take advantage of the tax incentives of investing in a Qualified Opportunity Zone Fund, so long as the investment is made within 180 days of the capital gains event.

There are three tax incentives for investing in a Qualified Opportunity Zone Fund — deferral, reduction, and exclusion.

1. **Deferral** of capital gains invested until December 31, 2026.
2. **Reduction** of capital gains invested. The cost basis on the original capital gains invested in an QOZ fund can be stepped up by 10 percent after 5 years; and an additional 5 percent after 7 years, leading to a 15 percent reduction in capital gains tax.
3. **Exclusion** of gain on qualified opportunity zone property held for at least 10 years.

How to invest in Qualified Opportunity Zone Funds

Anyone with capital gains may invest in Opportunity Zone Funds. Minimum investments are often in the 5- or 6-figure dollar range. As of now, several dozen such funds exist.

Once the Treasury Department releases their final regulations later in 2019, there should be many more opportunity funds created.

Chapter 1: Inequality in America and the promise of place-based policies

By most appearances, the economic recovery in the United States since the Great Recession of 2007-08 has been nothing short of phenomenal. By May 2018, unemployment had dropped to 3.8 percent, its lowest rate in decades. GDP is growing at 2-3 percent per year. The stock market is continually reaching new heights.

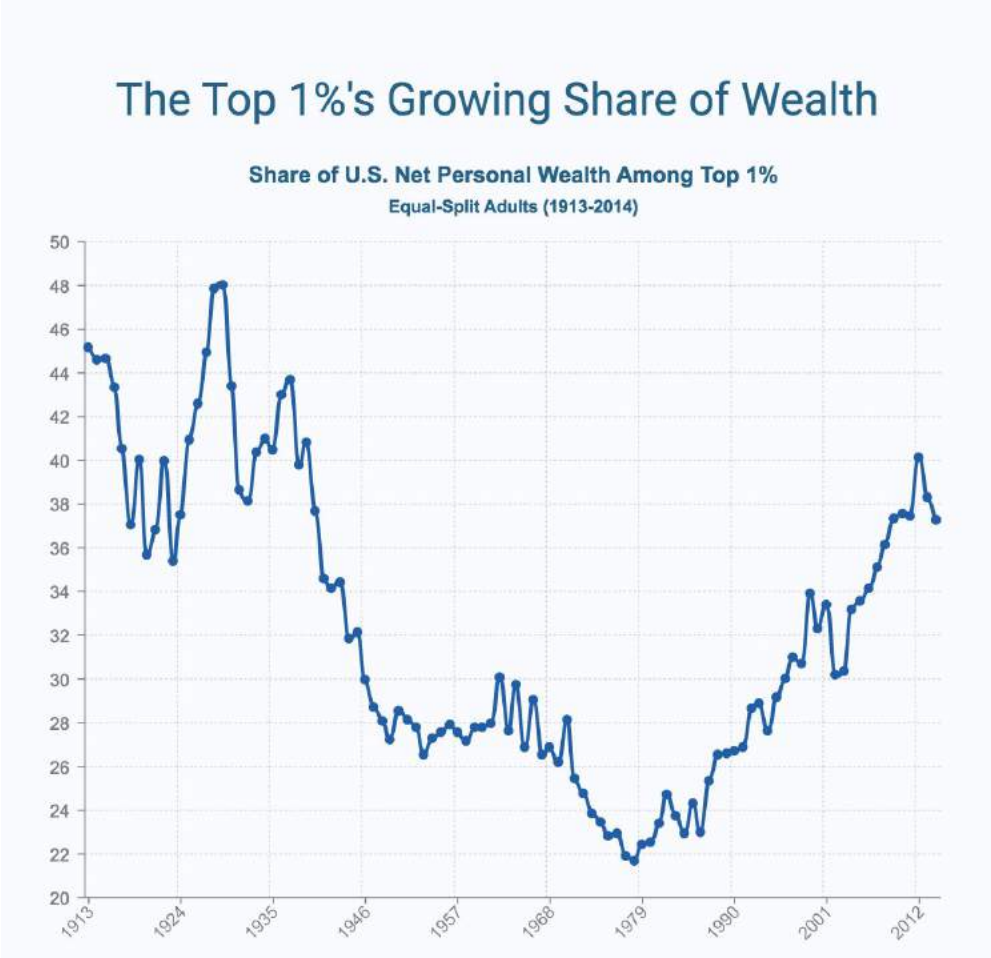
But if you look below the surface, it becomes clear that this growth is going only to a handful of communities in this country.

Inequality in the United States… is it a problem?

So long as we have capitalism, we will have inequality. It's inherent in the system. And that's not necessarily a bad thing. But at what point does inequality do more harm than good? And has the United States already passed an acceptable level of inequality? By just about any measure, inequality in the U.S. today is at its highest point in decades.

The share of the nation's wealth held by the top 1% is at its highest level since World War II. Over the past century, inequality in the U.S. peaked during the Roaring Twenties. Wartime economic policies and subsequent post-war expansion resulted in the Great Compression: from 1937 to 1947, Roosevelt's New Deal policies helped raise the incomes of the poor and working class and lowered that of top earners.

But beginning in the late 1970s, these trends began to reverse. For roughly the past 40 years, economic inequality has been on the rise. The chart below presents the share of U.S. net personal wealth among the top 1% over the last 100 years.



The chart below further illustrates the Great Divergence that began at the end of the 1970s. For much of the 1970s, the top 1% of income earners in the U.S. earned roughly 11 percent of income, while the bottom 50% earned roughly 20 percent. Today's figures show almost a perfectly mirrored image: the top 1% earns 20 percent, while the bottom 50% earns about 13 percent.

Does a rising tide lift all boats?

There is little debate that economic inequality is growing. (Although its impact has been challenged by some.) But it could be argued that growing inequality would not matter so long as the rising economic tide were to lift all boats, so to speak. In other words, so long as people on the lowest rungs of the socioeconomic ladder were increasing their economic prosperity over time, growing inequality may not concern us as much.

But is this the case?

An August 2018 study by the Pew Research Center finds that for most U.S. workers, inflation-adjusted wages have not moved in the last 40 years. And most wage gains have gone to the highest earners.

Among the points made in the study:

- Since 2000, inflation-adjusted usual weekly wages have risen just 3 percent among workers in the lowest decile of earnings.
- Over this same time period, among people in the top decile of earnings, real wages have risen 15.7 percent.

So yes, to a certain extent, the rising economic tide has in fact lifted all boats. Even wage earners at the very bottom of the ladder have more purchasing power today than they did 18 years ago, albeit just 3 percent more.

Conversely, this study of sluggish and uneven wage growth is one more key factor behind widening inequality in the United States.

But why should we be concerned with inequality? At high enough levels, inequality can have very negative consequences for everyone. It can lead to reduced middle-class income growth and increased disparities in education, happiness, and health. And as Bill Gates points out, high levels of inequality can wreak havoc on economic incentives, and ultimately skew democracies toward powerful interests.

Has inequality in the United States reached a tipping point where it is doing more harm than good? Left unchecked, capitalism alone is not likely to self-correct toward more equality. So, is it time for government to step in with more muscle?

The unevenness of the post-recession recovery

To help us further deal with the unevenness of the economic recovery that has followed the financial crisis of 2007-08, it is helpful to look at EIG's Distressed Communities

Index and associated statistics that help define the economic vitality of communities around the country.

Based on Census Bureau data from 2011-15, EIG's DCI combines seven metrics to arrive at an assessment of community economic well-being.

1. Adults without a high school diploma
2. Poverty rate
3. Prime-age adults not in work
4. Housing vacancy rate
5. Median income ratio
6. Change in employment
7. Change in establishments

Based on the averages from these seven metrics, ZIP codes are divided equally into quintiles with these labels:

1. Top 20%: Prosperous
2. Next 20% Comfortable
3. Middle 20%: Mid-Tier
4. Next 20%: At-Risk
5. Bottom 20%: Distressed

Economically distressed communities (the bottom 20% of all ZIP codes in this index) are home to 52.3 million Americans, about 17 percent of the U.S. population. The South has a disproportionately high number of distressed communities according to the index.

Prosperous ZIP codes dominated the recovery. They contained 29 percent of the nation's jobs in 2011, but have been home to 52 percent of new jobs created in the following five years. Further, Prosperous ZIP codes captured 57 percent of the national rise in business establishments from 2011-2015, nearly double their share of businesses in 2011.

Meanwhile, Distressed ZIP codes shed more than 17,000 businesses during the period.

Vacant rowhouses in Baltimore

Over the five-year period ending in 2015, the U.S. added 10.7 million jobs and 310,000 businesses. But that impressive growth was concentrated in Prosperous ZIP codes, 85 percent of which saw an increase in businesses during 2011-2015. Conversely, only 22 percent of Distressed communities saw an increase in businesses during that time period.

The health toll of the disparity is also striking. On average, those living in distressed communities will die five years sooner. And death as the result of mental and substance abuse disorders is 64 percent higher in Distressed counties than in Prosperous ones.

How are we to deal with the unevenness of economic growth in the United States? First, we need to answer a hard question: why are a small handful of places capturing all of

the gains from the economy and getting all of the capital investment, while everywhere else is getting left behind?

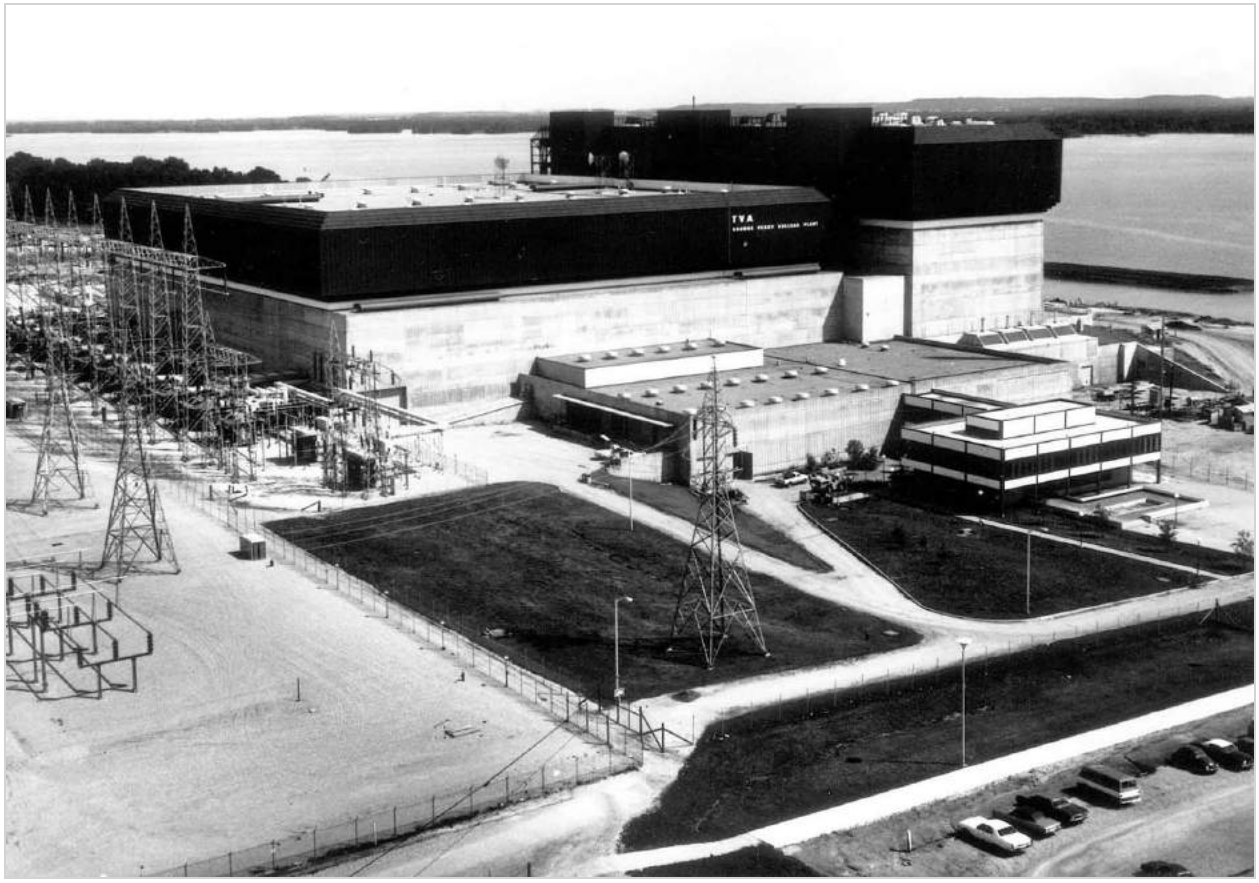
The promise of place-based economic development

Place-based economic development is based on the concept of economies of agglomeration, which considers that locations dense in jobs and people are more efficient and productive.

The Tennessee Valley Authority was formed in 1933 as part of Roosevelt's New Deal. It marks one of the federal government's earliest attempts at place-based policy-making. Its goal was to modernize the economy of the Tennessee Valley region with public infrastructure investment in hydroelectric dams, providing power for local manufacturing.

The most prominent form of place-based economic development in the United States today is federal and state urban enterprise zones, sometimes referred to as empowerment zones. Established in 1994 under the Clinton administration, the Empowerment Zone Program created empowerment zones and enterprise zones. The New Markets Tax Credit (NMTC) Program that was formed as part of the Community Renewal Tax Relief Act of 2000 subsequently established renewal communities.

Under the NMTC program, local community development entities (CDEs) apply for allocation authority — the authority to raise a certain amount of tax-advantaged capital from investors. NMTC program grants roughly $3.5 billion per year. The credit is 39% of the investment, and is paid out over the course of seven years, which results in about $1.365 billion in tax credits per year.



Tennessee Valley Authority power plant

These programs didn't just offer tax breaks for investors and businesses. They also poured government grants into communities to be spent on skills training and welfare-to-work initiatives.

Opportunity Zones are different in that there is no government grant money. It's entirely private-sector driven. Investors have far fewer hoops to jump through. And the pool of money being tapped is potentially enormous compared to the NMTC.

EIG estimated that $6.1 trillion in unrealized capital gains are eligible for preferential tax treatment under the Opportunity Zones initiative, as of year-end 2017. Experts there have estimated that this could be a $100 billion per year asset class. Compare that to the $3.5 billion NMTC program, and you can quickly see how much more transformative the Opportunity Zones program could be.

A common criticism of the program is that it could amount to nothing more than a gentrification subsidy, as there are no community benefit requirements. State and city authorities will need to come in to counterbalance the temptation for investors to put their money in zones already on their way to gentrification. Local government can use different tools to restrict the growth of undesirable businesses or too much luxury housing.

Conclusion

Inequality in the U.S. is worsening. But with new legislation passed as part of the Tax Cuts & Job Act, this imbalance has the potential to change. Opportunity Zones as defined in the Act create huge incentives for impact investing, allowing it to tap into a pool of approximately $6.1 trillion. And it has the potential to become what one expert has called "the biggest economic development program in U.S. history."

Chapter 2: The Investing in Opportunity Act

> *"It will be the biggest economic development program in U.S. history."*

So says Steve Glickman, co-founder and former CEO of the Economic Innovation Group, and one of the chief architects of the Investing in Opportunity Act.

Here's why Glickman is so optimistic: Among U.S. investors and corporations, approximately $6.1 trillion in unrealized capital gains is sitting on the sidelines, as of the end of 2017.

Additionally, hundreds of billions of dollars of capital gains *are* realized every year. (In 2014, Americans claimed $716 billion in realized capital gains on their tax returns.)

These are huge pools of money.

And it's these pools of money that the Investing in Opportunity Act (IIOA) — passed in December 2017 as a provision of President Trump's Tax Cuts & Jobs Act (H.R.1) — was designed to tap into for the benefit of some of the most economically distressed areas of the nation.

It does so by defining **qualified opportunity zones** and by creating an entirely new investment vehicle to invest in such zones — the **qualified opportunity fund**. And by providing three huge tax incentives for capital gains deployment into these new funds.

The tax benefits are explained in more detail in Chapter 4: What are opportunity funds? But in brief, they are:

1. Deferral of capital gains invested in qualified opportunity funds until December 31, 2026.
2. A 15 percent step-up in basis of capital gains invested in qualified opportunity funds.
3. Zero federal tax owed on capital gains from qualified opportunity fund investments.

A brief history of the Investing in Opportunity Act

The Investing in Opportunity Act is bipartisan legislature, co-authored by Senators Tim Scott (R-SC) and Cory Booker (D-NJ) and Congressmen Pat Tiberi (R-OH) and Ron Kind (D-WI), and championed by nearly 100 congressional co-sponsors. It was initially introduced to both the Senate (S.293) and House (H.R.828) on February 2, 2017.

The Economic Innovation Group originally developed the idea in a white paper titled Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas, published in April 2015. The paper — authored by Jared Bernstein of the Center on Budget and Policy Priorities, and Kevin A. Hassett of the American Enterprise Institute — makes no mention of "opportunity zones" or "opportunity funds," but lays the groundwork for the preferential treatment of capital gains deployed to distressed areas of the country.

Senators Tim Scott (R-SC) and Cory Booker (D-NJ) were co-sponsors of the Investing in Opportunity Act.

The Investing in Opportunity Act encourages investment in economically distressed communities by offering three huge tax incentives.

What is a low-income community?

The intent of the Investing in Opportunity Act is to funnel investment into low-income communities that have long been overlooked. But, what is a low-income community exactly?

The legislation defines “qualified opportunity zones” as low-income census tracts that are nominated by each state’s governor and subsequently certified by the U.S. Treasury as qualified opportunity zones.

For purposes of defining an opportunity zone, the term “low-income community” takes its definition from Section 45D(e) of the IRS Code, which states that a population census tract, in general, is low-income if:

> *(A) the poverty rate for such tract is at least 20 percent, or*
>
> *(B) (i) in the case of a tract not located within a metropolitan area, the median family income for such tract does not exceed 80 percent of statewide median family income, or (ii) in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income.*

There are a few caveats to this definition that deal with targeted populations, areas not located within census tracts, low-population tracts, and high-migration rural communities, which are explained in more detail in the code.

What is a contiguous non-LIC census tract?

A non-low-income community (non-LIC) census tract can be designated as an opportunity zone if it is:

> *(A) … contiguous with the low-income community that is designated as a qualified opportunity zone, and*

> *(B) the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tracts is contiguous.*

But no more than 5 percent of a state's opportunity zones can be contiguous non-LIC tracts.

Qualified opportunity zone designations

The legislation called for governors from all 50 states and U.S. territories, plus the mayor of Washington DC, to nominate low-income census tracts from their jurisdictions. The governors could nominate up to 25 percent of their low-income census tracts.

An exception was made for states with fewer than 100 eligible tracts; these states were allowed up to 25 tracts to be designated as opportunity zones. Alaska, Delaware, District of Columbia, Guam, Hawaii, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming were able to take advantage of this exception: they each have exactly 25 opportunity zones.

American Samoa, Northern Mariana Islands, and Virgin Islands each have fewer than 25 eligible census tracts. As a result, 100 percent of their eligible tracts were designated as opportunity zones.

Additionally, the 2018 Bipartisan Budget Act allowed for every low-income census tract and eligible non-LIC census tract in Puerto Rico to be certified as a qualified opportunity zone. As a result, nearly the entire island of Puerto Rico is essentially one large federal opportunity zone.

The zone designations remain effective through the end of 2028.

More detail on opportunity zones can be found in Chapter 3.

Puerto Rico suffered massive damage from Hurricane Maria in 2017.

The creation of the qualified opportunity fund

To receive the preferential tax treatment that opportunity zone investing offers, investments must flow through a newly created investment vehicle — the qualified opportunity fund.

Opportunity funds can be structured as corporations or partnerships. Opportunity funds invest substantially in opportunity zone businesses, opportunity zone business property, or a combination of the two. In general, an opportunity fund must hold at least 90 percent of its assets in qualified opportunity zone businesses or business property.

Certain “sin” businesses (golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other facilities used for gambling, and liquor stores) are ineligible to qualify as opportunity zone businesses.

More detail on opportunity funds can be found in Chapter 4.

Chapter 3: What are opportunity zones?

An opportunity zone is a low-income census tract that has been nominated by its state governor and certified by the Treasury Department. The nation’s opportunity zones stand poised to receive a huge influx of investment, given the enormous tax incentives that the new legislation has created.

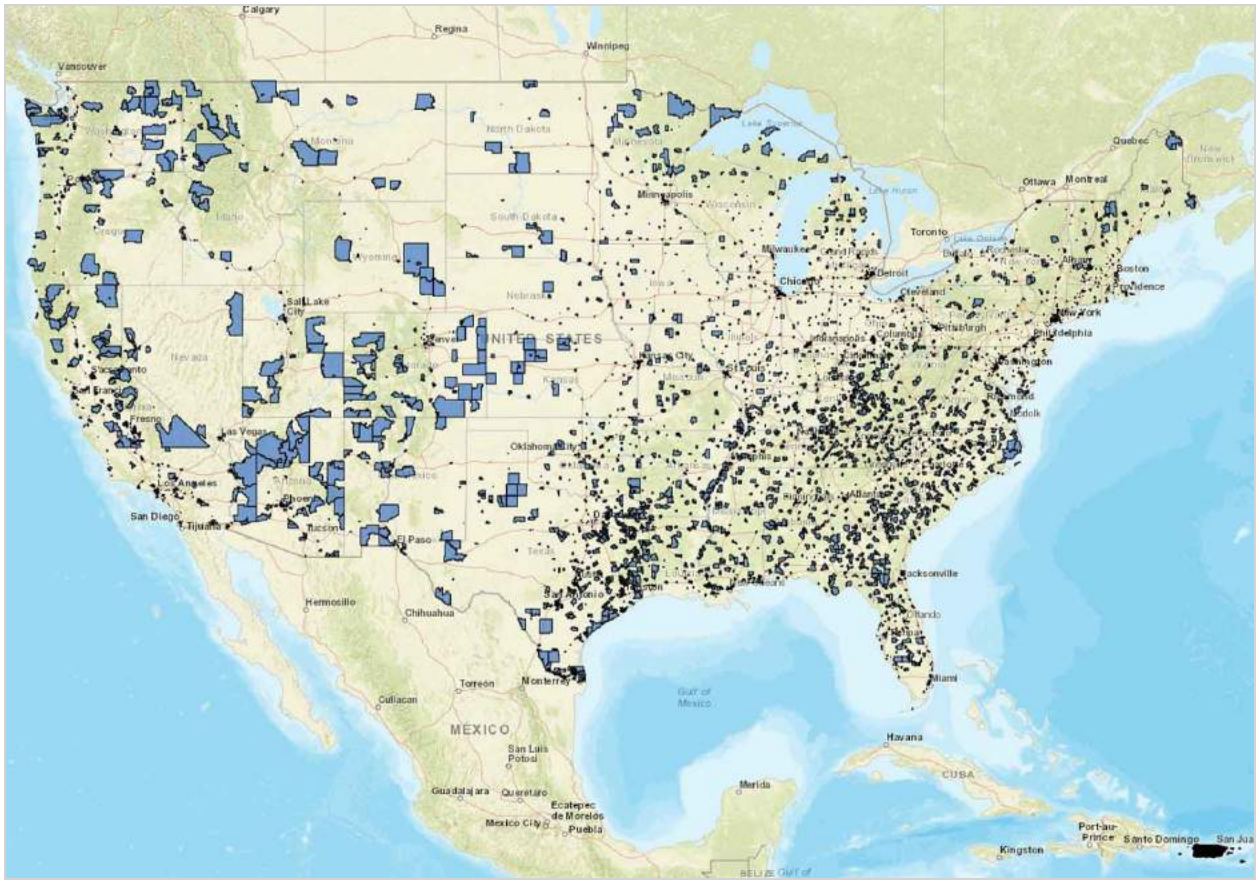
The Investing in Opportunity Act makes a big promise to these zones. But will the promises of economic growth (without too much resident displacement) come to fruition?

Opportunity zone facts and figures

On June 14, 2018, the U.S. Treasury and IRS finalized certification of the opportunity zones. In total, 8,762 census tracts were certified as qualified opportunity zones. These zones are located in all 50 states, the District of Columbia, and all five inhabited overseas territories. In December 2018, Puerto Rico was granted two additional opportunity zones, bringing the total to 8,764.

A total of 8,534 out of 31,866 census tracts defined as low-income were designated as opportunity zones. An additional 230 eligible contiguous tracts (not defined as low-income) were designated to bring the total to 8,764.

Nearly 35 million Americans live in these zones, per 2015 American Community Survey data. The average poverty rate in the opportunity zones is 32 percent, compared to 17 percent for the average census tract.



A total of 8,764 census tracts are certified as qualified opportunity zones.

Here's the breakdown by state:

LOCATION	DESIGNATED OPPORTUNITY ZONES	LOW-INCOME TRACTS	NON-LIC CONTIGUOUS TRACTS
Alabama	158	153	5
Alaska	25	25	0

American Samoa	16	16	0
Arizona	168	160	8
Arkansas	85	83	2
California	879	871	8
Colorado	126	119	7
Connecticut	72	71	1
Delaware	25	24	1
Florida	427	427	0
Georgia	260	260	0
Guam	25	23	2
Hawaii	25	23	2
Idaho	28	26	2
Illinois	327	327	0
Indiana	156	153	3
Iowa	62	61	1
Kansas	74	70	4
Kentucky	144	139	5
Louisiana	150	145	5

Maine	32	30	2
Maryland	149	145	4
Massachusetts	138	137	1
Michigan	288	283	5
Minnesota	128	127	1
Mississippi	100	95	5
Missouri	161	153	8
Montana	25	25	0
Nebraska	44	43	1
Nevada	61	60	1
New Hampshire	27	27	0
New Jersey	169	169	0
New Mexico	63	59	4
New York	514	497	17
North Carolina	252	241	11
North Dakota	25	25	0
Northern Mariana Islands	20	20	0
Ohio	320	317	3

Oklahoma	117	114	3
Oregon	86	81	5
Pennsylvania	300	289	11
Puerto Rico	863	837	26
Rhode Island	25	25	0
South Carolina	135	128	7
South Dakota	25	23	2
Tennessee	176	170	6
Texas	628	628	0
Utah	46	46	0
Vermont	25	23	2
Virgin Islands	14	13	1
Virginia	212	207	5
Washington	139	132	7
Washington DC	25	25	0
West Virginia	55	52	3
Wisconsin	120	120	0
Wyoming	25	24	1

Opportunity zone ideals

By design, the Opportunity Zones program targets under-invested low-income communities on the margins — places where private investment would be highly catalytic. The very worst-off places in the nation are just not capable of attractive private investment. Conversely, communities already on an upswing would be a waste of program dollars.

As Annie Lowery puts it in The Atlantic, "Opportunity zones are meant to be Goldilocks-type places: not so distressed that no amount of government incentive would induce private money to them, not distressed but gentrifying and thus already seeing a flood of private money coming in."

How to invest in opportunity zones

Taxpayers wishing to invest in opportunity zones are required to deploy capital gains in qualified opportunity zone funds. Opportunity zone funds are structured as corporations or partnerships and invest in qualified opportunity zone property.

What is qualified opportunity zone property?

OZ property can be one of two things — 1) an opportunity zone business; or 2) opportunity zone business property. An opportunity zone business can be structured as either a corporation or a partnership and must hold at least 90 percent of its assets in OZ property. Opportunity zone business property is tangible property used in trade or business of a qualified opportunity fund.

Opportunity zone property is explained in more detail in Chapter 4: What are qualified opportunity funds?

Opportunity Zones vs. NMTC

The most recent place-based economic policy is the New Markets Tax Credit program. Much of the opportunity Zones regulatory language is borrowed from the NMTC program, but there are a few substantial differences.

Program Mechanics

Each program was developed to incentivize capital investment in under-invested areas of the country. But there are key differences in the mechanics of how this goal is achieved.

Under the NMTC program, a taxpayer invests cash in a special financial intermediary termed a Community Development Entity (CDE), which then invests in businesses within a zone. Each CDE must be pre-approved by the Treasury Department and is required to provide governance rights to community representatives.

Under the Opportunity Zones program, there is much less oversight. A taxpayer invests capital gains into qualified opportunity zone funds, which then invests in businesses within a zone. But unlike CDEs, which must be pre-approved by Treasury, Opportunity Zone funds simply self-certify. There is zero pre-approval process, no community benefit requirement, and no requirement to provide governance rights to community representatives.

Tax Benefit

The tax benefit differs substantially as well. In the NMTC program, a dollar-for-dollar annual tax credit equal to the amount invested in a Community Development Entity (CDE) is granted to the taxpayer. But the taxpayer would still owe tax on any gains realized by the CDE.

The U.S. Treasury department oversees both the NMTC and OZ programs.

But under the Opportunity Zones program, investors can deploy capital gains from any asset into a qualified opportunity zone fund. There are three tax benefits of this program: 1) deferral of capital gains tax until December 31, 2026; 2) reduction of capital gains tax due; 3) elimination of tax due on capital gains from opportunity zones investments.

Financial Impact

The NMTC allocates $3.5 billion in qualified equity investments annually. Conversely, the opportunity zones program has no limit to the amount of investment that can be made. Because of this, some believe that the opportunity zones program will dwarf the NMTC in terms of financial impact.

EIG's fomer CEO Steve Glickman has called the opportunity zones program "the biggest economic development program in U.S. history." And Treasury Secretary Steven Mnuchin believes there will be "over $100 billion of private capital" invested in opportunity zones.

Chapter 4: What are qualified opportunity funds?

Qualified opportunity funds were created under the Investing in Opportunity Act, which was passed as part of President Trump's Tax Cuts & Jobs Act of 2017. Per the IRS, opportunity funds self-certify, with no approval process required. These new funds provide massive tax incentives for investing capital gains in some of America's most economically distressed communities.

Qualified opportunity funds defined

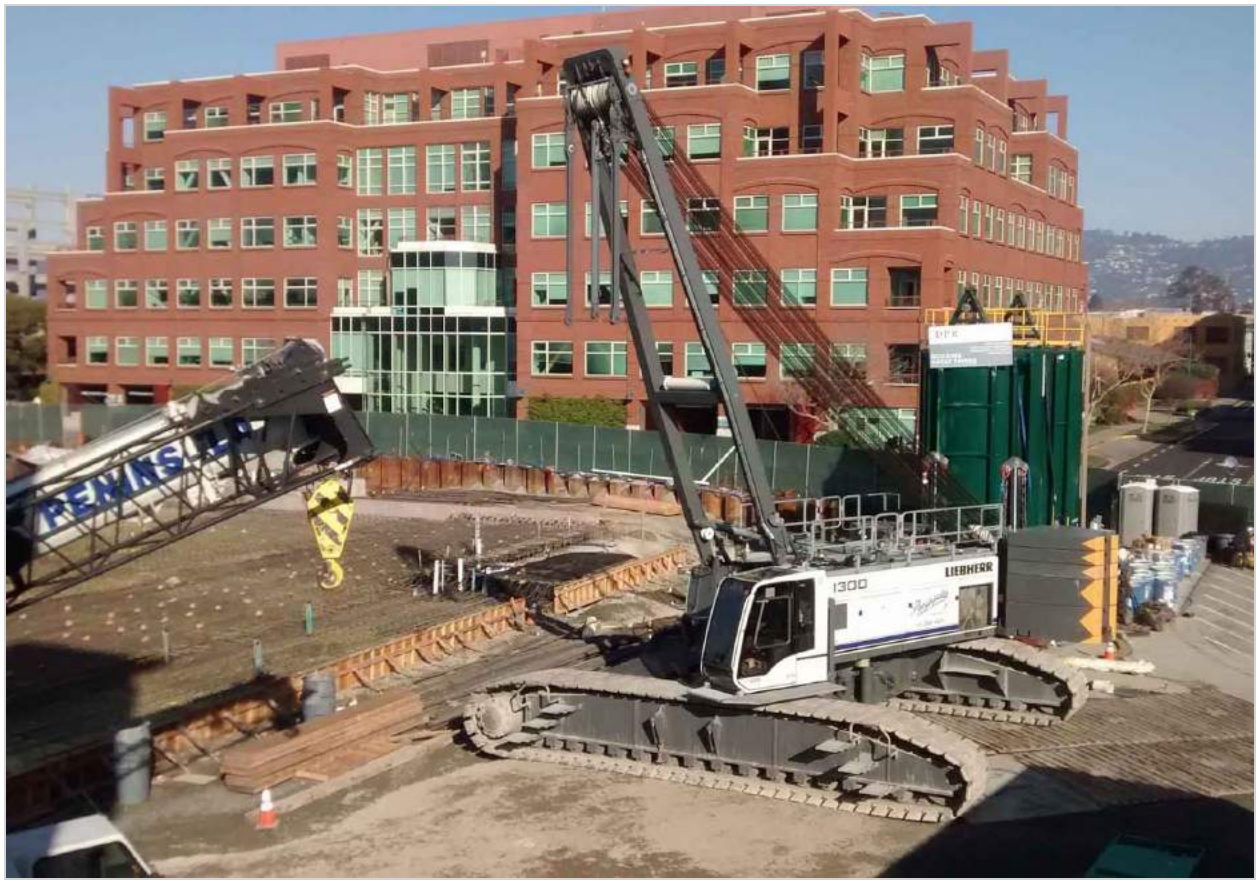
The U.S. tax code defines a **qualified opportunity fund** as an investment vehicle that invests in **qualified opportunity zone property**. Specifically as follows:

> *The term "qualified opportunity fund" means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured—(A) on the last day of the first 6-month period of the*

taxable year of the fund, and (B) on the last day of the taxable year of the fund.

Opportunity zone property can be either an **opportunity zone business** or **opportunity zone business property**. Put another way, an opportunity fund has two options:

1. It can invest in opportunity zone businesses that hold tangible property located within opportunity zones.
2. It can essentially become an opportunity zone business by investing directly in tangible property located within opportunity zones.



Many expect opportunity zone funds to kickstart real estate development in previously under-invested areas.

Let's now define these two terms — qualified opportunity zone business and qualified opportunity zone business property.

Qualified opportunity zone business

An opportunity zone business can be either a corporation or partnership. In general, an opportunity zone business is a trade or business in which substantially all of the tangible property of the business qualifies as follows:

- Such property was acquired by the business by purchase after December 31, 2017.
- The original use of such property in the opportunity zone commences with the opportunity zone business, or the opportunity zone business substantially improves the property.
- During substantially all of the opportunity zone business' holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

Furthermore, the opportunity zone business must also adhere to the following criteria:

- At least 50 percent of the total gross income of the opportunity zone business is derived from the active conduct of such business.
- A substantial portion of the intangible property of the opportunity zone business is used in the active conduct of such business.
- Less than 5 percent of the average of the aggregate unadjusted bases of the property of an opportunity zone business is attributable to nonqualified financial property.

And finally, the following types of "sin" businesses are ineligible to be deemed as a qualified opportunity zone business — private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or liquor stores.

Qualified opportunity zone business property

Opportunity zone business property is tangible property used in a trade or business of a qualified opportunity fund, so long as it meets the following three conditions:

1. Such property was acquired by the qualified opportunity fund by purchase after December 31, 2017.
2. The original use of such property in the opportunity zone commences with the qualified opportunity fund, or the fund substantially improves the property.
3. During substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

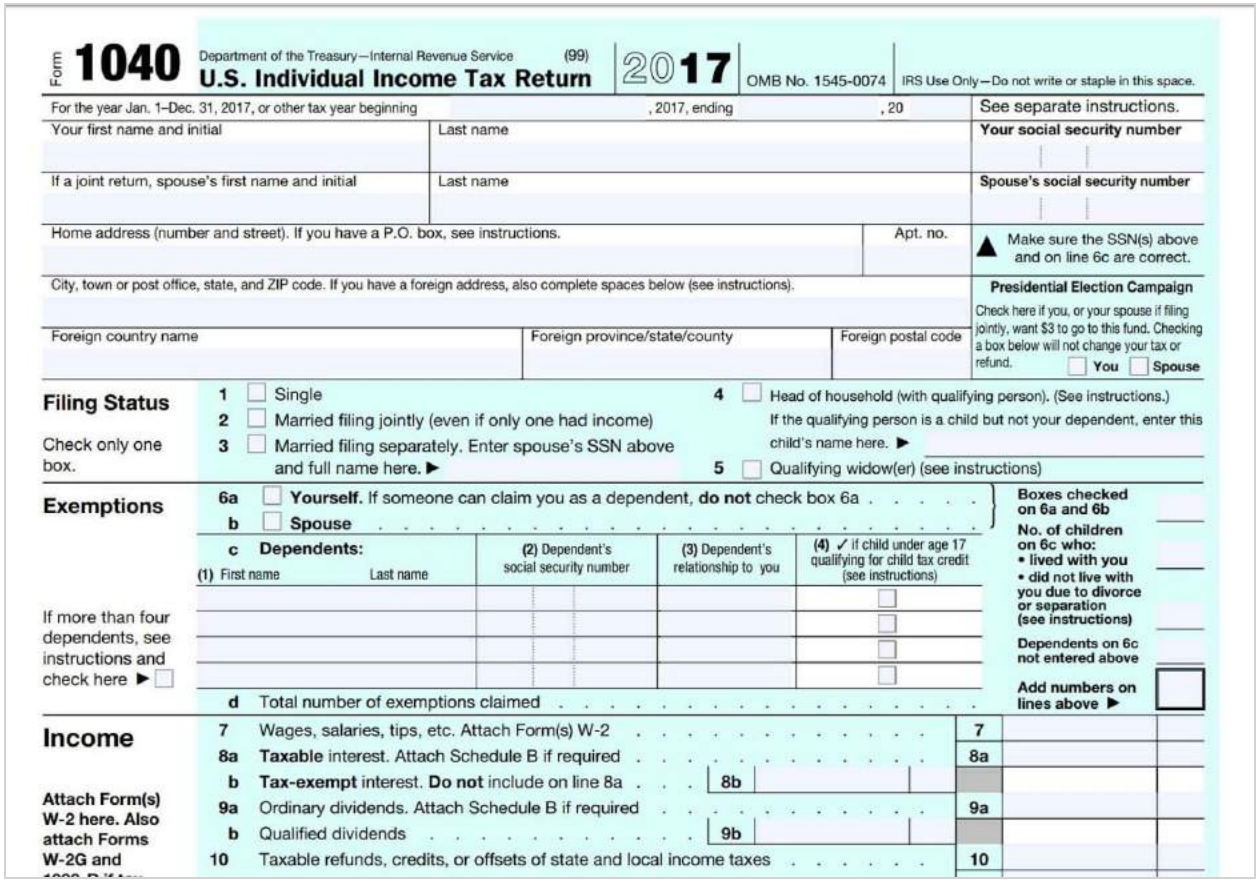
Tax advantages of opportunity fund investing

To encourage capital deployment to economically distressed opportunity zones, three tax advantages were created for capital gains invested in opportunity funds.

1. Deferment of capital gains until December 31, 2026.
2. A step-up in basis of up to 15 percent on the original gain.
3. Elimination of capital gains accrued in the opportunity fund after a 10-year holding period.

Advantage #1: Deferral of capital gains until December 31, 2026

Any capital gains rolled into an opportunity fund within 180 days will be tax deferred until December 31, 2026, or the date on which the opportunity fund investment is sold, whichever is earlier.



Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2017** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20 See separate instructions.

Your first name and initial | Last name | Your social security number

If a joint return, spouse's first name and initial | Last name | Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). | Presidential Election Campaign

Foreign country name | Foreign province/state/county | Foreign postal code | Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. You Spouse

Filing Status Check only one box.
1 Single
2 Married filing jointly (even if only one had income)
3 Married filing separately. Enter spouse's SSN above and full name here. ▶
4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 Qualifying widow(er) (see instructions)

Exemptions
6a Yourself. If someone can claim you as a dependent, do not check box 6a
b Spouse
c Dependents: (1) First name Last name | (2) Dependent's social security number | (3) Dependent's relationship to you | (4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
If more than four dependents, see instructions and check here ▶
d Total number of exemptions claimed
Boxes checked on 6a and 6b
No. of children on 6c who: • lived with you • did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above
Add numbers on lines above ▶

Income Attach Form(s) W-2 here. Also attach Forms W-2G and
7 Wages, salaries, tips, etc. Attach Form(s) W-2 — 7
8a Taxable interest. Attach Schedule B if required — 8a
b Tax-exempt interest. Do not include on line 8a — 8b
9a Ordinary dividends. Attach Schedule B if required — 9a
b Qualified dividends — 9b
10 Taxable refunds, credits, or offsets of state and local income taxes — 10

Qualified opportunity zone fund investments offer three unique tax benefits to taxpayers.

Advantage #2: Step-up in basis of capital gains

Capital gains rolled into an opportunity fund within 180 days are eligible for a step-up in basis at year 5 and year 7. The basis of the original investment is stepped up by 10 percent after the opportunity fund investment is held for 5 years, and by an additional 5 percent if the opportunity fund is held for 7 years, so long as these milestones hit before December 31, 2026 (the date on which the original capital gain must be recognized).

If by December 31, 2026 the investor has held his opportunity fund investment for 5 or 6 years, his capital gains on the original investment is effectively reduced by 10 percent.

If by December 31, 2026 the investor has held his opportunity fund investment for 7 years or more, his capital gains on the original investment is effectively reduced by 15 percent.

The reduced capital gains tax payment would come due in April 2027.

Advantage #3: No tax owed on capital gains from opportunity fund investments

This is by far the biggest benefit of the opportunity zones program, and the #1 reason why Treasury Secretary Steven Mnuchin expects more than $100 billion in investments to flow to opportunity zones as a result of this program.

So long as an opportunity fund investment is held for at least 10 years, the basis of the investment will be adjusted to be equal to the fair market value of the investment on the date on which it is sold. In other words, there is zero capital gains tax due on any profits from the sale of an opportunity fund investment after a 10-year holding period.

Opportunity zone fund vs. Section 1031 exchange

Savvy investors are familiar with 1031 exchanges. And opportunity zones appear similar at first glance. But there are a few substantial differences, summarized below.

Rollover

In a Section 1031 exchange, and investor must reinvest both the principal and capital gain within 180 days. And this transaction must be conducted through a qualified intermediary.

With an opportunity zone investment, an investor is only responsible for rolling over the capital gains within 180 days. The investor is not required to deploy the entire gain, but only the rolled over portion is eligible for tax advantages. Moreover, the principal can be

used for anything. It does not need to be rolled over. And, placing an investment in an opportunity fund is much more straightforward, with no intermediary required.

Qualified assets

Only real estate gains are eligible for 1031 like-kind exchanges. Whereas, capital gains from any type of asset sale (real estate, stocks, bonds, etc.) can qualify for investment in an opportunity fund.

Investment structure

A Section 1031 exchange is structured to allow for single asset swaps, usually one real estate property for another real estate property. Multiple properties can be supported, but this option usually comes with higher costs and less flexibility.

On the other hand, opportunity funds are pooled funds that can invest in multiple properties across asset classes and geographies.

Capital gains tax deferral

Capital gains tax payments on a 1031 exchange can be deferred indefinitely. With opportunity funds, capital gains of the initial investment may be deferred until December 31, 2026.

Capital gains tax reduction

With 1031 exchanges, a capital gains are reduced through a step-up in basis only upon death. With opportunity funds, the investor receives basis step-ups of 10 percent after 5 years and an additional 5 percent after 7 years, to account for a total available capital gains tax reduction of 15 percent.

Capital gains tax on final sale

With a 1031 exchange, the investor owes capital gains tax on final sale of the asset.

This may be the best benefit of an opportunity fund: zero capital gains tax is due on any appreciation of the opportunity fund investment upon sale, so long as the investment is held for at least 10 years.

Appendix: How much money can opportunity zone investing save taxpayers?

Taking advantage of opportunity zone investing can save a taxpayer thousands or even millions of dollars on his tax bill. Using our opportunity fund tax calculator, it's easy to see how powerful the incentive is to invest in opportunity zones.

Note: *The U.S. Treasury department has not yet finalized its guidelines on capital gains invested in opportunity zones. As such, it is still unclear how certain provisions of the existing legislation would apply, particularly when it comes to the timing of 5-year, 7-year, and 10-year milestones, and how they pertain to stepping up basis on the original investment.*

To demonstrate the potential for tax savings, let's look at a few different hypothetical examples.

Example #1: $100,000 capital gain invested in opportunity fund doubles in value after 10-year holding period

In our first example, assume that The Investor realizes a $100,000 capital gain on his original investment. This could be from sale of any asset (stock, mutual fund, real estate). It doesn't matter where the gain came from.

On December 31, 2018, The Investor invests the $100,000 capital gain in a qualified opportunity fund. Note: this investment must occur within 180 days of the cap gains realization. By April 15, 2019, The Investor simply needs to make an election on his tax filing, showing that this $100,000 capital gain has been rolled over into an opportunity fund. So long as The Investor does not sell or exchange his share in the opportunity fund, his original $100,000 gain is tax deferred until December 31, 2026.

In the meantime, his basis in the original investment effectively "steps up" twice. The first step-up in basis is 10 percent on the 5-year anniversary of the opportunity fund investment. In this example, this occurs on December 31, 2023.

The second step-up in basis is an additional 5 percent (bringing the total step-up in basis to 15 percent) on the 7-year anniversary. In this example, this occurs on December 31, 2025. Remember, the tax on the original $100,000 gain was deferred until December 31, 2026. Therefore, on April 15, 2027, The Investor finally owes capital gains tax on the original gain. But because he has received the full 15 percent step-up in basis from the original investment, instead of paying capital gains tax on the full $100,000 amount, he is now only obligated to pay capital gains tax on $85,000.

Assuming a capital gains tax rate of 20%, The Investor would have a tax bill of $17,000 due on April 15, 2027. Without the opportunity fund investment, The Investor would otherwise have owed $20,000 in capital gains tax on April 15, 2019.

Furthermore, let's assume that after a 10-year holding period, the investment in the opportunity fund has doubled. The Investor's $100,000 share in the opportunity fund is worth $200,000 when he sells it on December 31, 2028. Having held the opportunity fund for at least 10 years, The Investor is now able to waive his entire gain for tax purposes. He owes 0 on the subsequent $100,000 gain.

In this example, The Investor effectively paid only $17,000 in capital gains tax on $200,000 in total gains. Without the opportunity zones tax rules, an investor would normally owe $40,000 in taxes on $200,000 in capital gains (assuming a 20% rate). Thus, The Investor has saved $23,000 in taxes.

Example #2: $100,000 capital gain invested in opportunity fund doubles in value after 8-year holding period

In our first example, The Investor took full advantage of the opportunity zones tax regulations by holding his opportunity fund for a full 10 years. This allowed him to pay no tax on his subsequent $100,000 gain.

In our second example, let's make all of the same assumptions, except change The Investor's holding period from 10 years to 8 years. The Investor now sells his share in the opportunity fund on December 31, 2026 for $200,000.

The Investor still receives the 15 percent step-up in basis on the original investment and pays $17,000 in capital gains tax on April 15, 2027. However, since The Investor did not hold his opportunity zone investment for the full 10 years, he owes tax on any gain in the fund. In our example, this is a subsequent gain of $100,000. Therefore, The Investor would owe an additional $20,000 in capital gains tax on April 15, 2027, for a total amount owed of $37,000. His savings from the opportunity zone investment is just $3,000, instead of the $23,000 in savings from the first example.

Example #3: $100,000 capital gain invested in opportunity loses value

Read about hypothetical opportunity fund investments just about anywhere, and they'll all assume a gain on the opportunity fund investment. But investments do actually lose value sometimes! Let's assume that in our final example.

The Investor has a gain of $100,000 from his original investment. Within 180 days, he invests this $100,000 in an opportunity fund. He holds the fund for 7 years, so he receives the 15 percent step-up in basis on his original investment before his deferred tax on the gains are due on April 15, 2027. He owes $17,000 on this date.

After a 10-year holding period (say, December 31, 2028), The Investor sells his opportunity fund share for $50,000, thereby realizing a loss of $50,000. He would owe no tax and in fact can use this loss against his income for 2028.

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