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Balance sheet

Opportunity Zones and Deferral of Capital Gains

By Jeffrey Quinlan, CPA

The 2017 Tax Cuts and Jobs Act created Qualified Opportunity Zones (QOZs) that allow investors to defer capital gains by investing in the QOZ. There are two benefits to investing in QOZs. First, an investor can temporarily defer gains by investing realized gains in a Qualified Opportunity Fund (QOF). Second, an investor can permanently exclude any realized gains that result if the QOF increases in value when they own the investment for 10 or more years.

The taxpayer defers the gains by selling investments to an unrelated person and investing the gain in a QOF within 180 days of the sale. A QOF is an investment that is organized as a corporation or partnership for investing QOZ property and holds at least 90% of its assets in QOZ property. An investor can invest gains from sales of capital assets and eligible 1231 gains. Ordinary gains are not eligible for the deferral of the gains.

The taxpayer will recognize a capital gain the earlier of when the QOF is sold or December 31, 2026, when the law sunsets. The amount included in income is the QOF's fair market value (FMV) less any basis if sold before December 31, 2026. If held until December 31, 2026, the amount included in income is the lesser of deferred gain less basis or FMV less basis. The initial tax basis in the QOF is usually zero. If the investor holds the QOF for five years then the basis is 10% of the deferred gain and the basis increases to 15% of the deferred gain if the investor holds the QOF for seven years.

Here is an example of deferring a taxable gain by investing in a QOF:



A taxpayer sells a stock for a \$50,000 gain on June 30, 2020, and the taxpayer pays 20% on capital gains or \$10,000 in taxes on this stock sale. Instead, the taxpayer invests the \$50,000 in a QOF. Below is a table of various taxable gains when the taxpayer sells the QOF:

	Date	Sales price or FMV	Basis	Capital Gain Recognized	Income tax on gain
Sold - held under five years	5/15/2025	\$25,000	\$0	\$25,000	\$5,000
	5/15/2025	\$50,000	\$0	\$50,000	\$10,000
	5/15/2025	\$75,000	\$0	\$75,000	\$15,000
Sold - held over five years	5/15/2026	\$25,000	\$5,000	\$20,000	\$4,000
	5/15/2026	\$50,000	\$5,000	\$45,000	\$9,000
	5/15/2026	\$75,000	\$5,000	\$70,000	\$14,000
Not sold	12/31/2026	\$25,000	\$5,000	\$20,000	\$4,000
	12/31/2026	\$50,000	\$5,000	\$45,000	\$9,000
	12/31/2026	\$75,000	\$5,000	\$45,000	\$9,000

As mentioned above, if the investor still owns the QOF on December 31, 2026, the gain is the lesser of FMV less basis or the deferred gain less basis. If the taxpayer sells the QOF after December 31, 2026, and before holding it 10 years, the basis is the amount recognized as a capital gain on December 31, 2026.

The second benefit is for investors that hold a QOF for 10 or more years. The post-acquisition increase in value can be excluded by increasing the investment's basis to its fair market value on the date of sale. In the above example, if the taxpayer sells the QOF on July 15, 2030, for \$100,000 and the fair market value was \$75,000 on December 31, 2026. The basis is \$50,000 and the taxpayer can elect to increase his basis to \$100,000 and not pay capital gains tax on the additional \$50,000 gain.

Please let us know if you have any additional or more detailed questions about investing in Qualified Opportunity Zones. Items presented are not intended to be technically complete. Additional information may be required to make an informed decision. You cannot rely upon this information for avoiding tax penalties.