

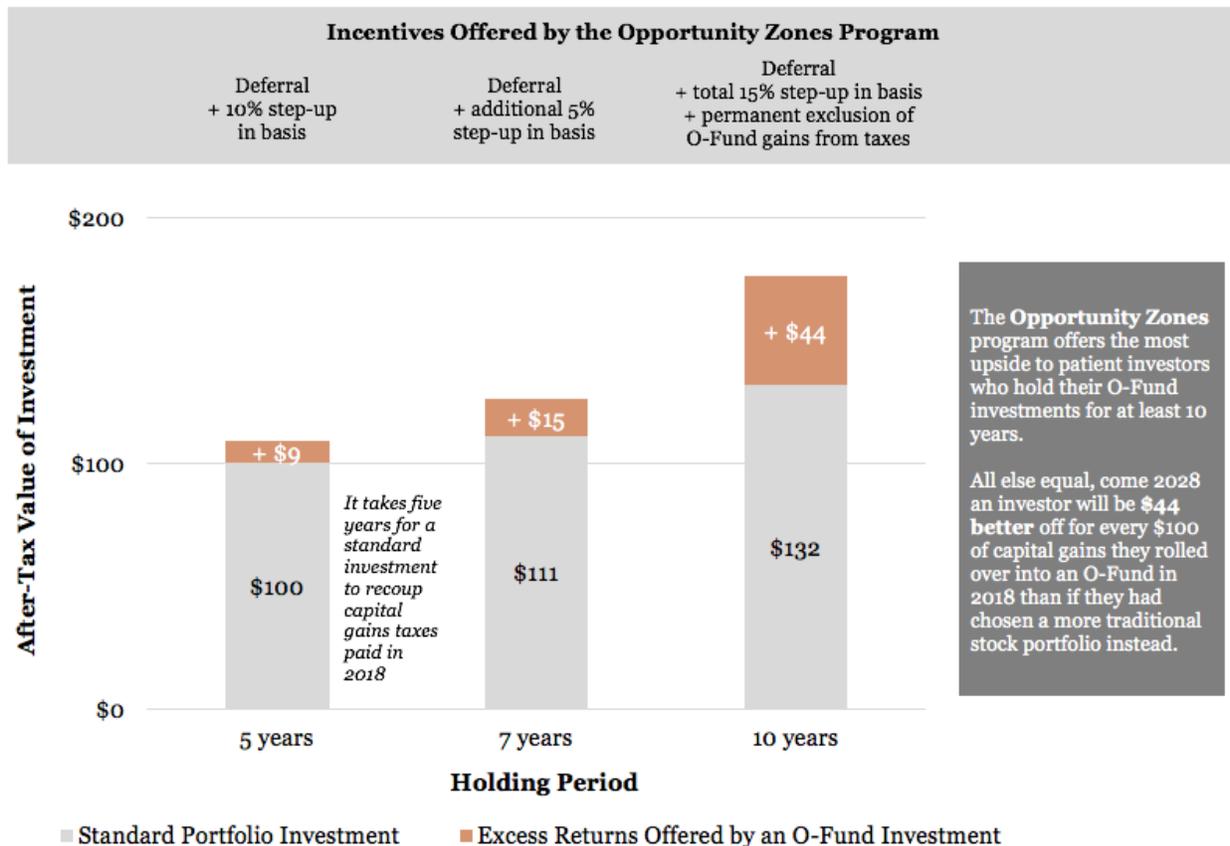
The Tax Benefits of Investing in Opportunity Zones

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The Opportunity Zones program offers three tax benefits for investing in low-income communities through a qualified Opportunity Fund¹:

1. A **temporary deferral** of inclusion in taxable income for capital gains reinvested in an Opportunity Fund. The deferred gain must be recognized on the earlier of the date on which the opportunity zone investment is disposed of or December 31, 2026.
2. A **step-up in basis** for capital gains reinvested in an Opportunity Fund. The basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least 5 years and by an additional 5% if held for at least 7 years, thereby excluding up to 15% of the original gain from taxation.
3. A **permanent exclusion** from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund if the investment is held for at least 10 years. This exclusion only applies to gains accrued *after* an investment in an Opportunity Fund.

Figure 1. Investing in an Opportunity Fund vs. a Standard Stock Portfolio
Scenario: A Capital Gain of \$100 is Reinvested in 2018



* Note: Assumes long-term federal capital gains tax rate of 23.8%, no state income tax, and annual appreciation of 7% for both the O-Fund and alternative investment.

How does the incentive work in practice? Illustrative examples:

The figure above, along with the table and examples below, show how an investor's after-tax funds available compare under different scenarios, assuming various holding periods, annual investment appreciation of 7%, and a long-term capital gains tax rate of 23.8% percent (federal capital gains tax of 20% and net investment income tax of 3.8%). The table provides additional information on the tax liabilities and differences in the after-tax annual rates of return. As is clear, the incentives built into the Opportunity Zones program are designed to reward *long-term* investments in distressed communities the most.

Table 1. Investing in an Opportunity Fund (O-Fund) vs. a Standard Stock Portfolio
Scenario: A Capital Gain of \$100 is Reinvested in 2018

Holding Period	Appreciation Rate	Investment in a Stock Portfolio		Investment in an Opportunity Fund		Difference in After-Tax Annual Rate of Return
		Total Tax Liability	After-Tax Funds Available	Total Tax Liability	After-tax Funds Available	
5 years	7%	\$31	\$100	\$31	\$109	1.9%
7 years	7%	\$35	\$111	\$35	\$126	1.8%
10 years	7%	\$41	\$132	\$20	\$176	3.0%

Example 1: Investor holds the O-Fund stake for 10 years

Susie has \$100 of unrealized capital gains in her stock portfolio. She decides in 2018 to reinvest those gains into an O-Fund that invests in distressed areas of her home state, and she holds that investment for 10 years. Susie is able to defer the tax she owes on her original \$100 of capital gains until 2026. Further, the basis is increased by 15% (effectively reducing her \$100 of taxable capital gains to \$85). Thus, she will owe \$20 (23.8% of \$85) of tax on her original capital gains when the bill finally comes due. In addition, since she holds her O-Fund investment for at least 10 years, she owes no capital gains tax on its appreciation. Assuming that her O-Fund investment grows 7% annually, the after-tax value of her original \$100 investment in 2028 is \$176. Susie has enjoyed a 5.8% effective annual return, compared to the 2.8% an equivalent non-O-Fund investment would have delivered.

Total tax bill in 2028: \$20

After-tax value of investment in 2028: \$176

Effective after-tax annual return on \$100 capital gain in 2018: 5.8%

Example 2: Investor holds the O-Fund stake for 7 years

As in Example 1, in 2018 Susie rolls over \$100 of capital gains into an O-Fund. She holds the investment for 7 years, selling in 2025. As in Example 1, she temporarily defers the tax she owes on her original capital gains and steps-up her basis by 15%, so that in 2025 she will owe \$20 (23.8% of \$85) of tax on her original capital gains. Unlike Example 1, however, Susie will owe capital gains tax on the appreciation of her O-Fund investment, since she holds the investment for less than 10 years. Assuming that her O-Fund investment grows 7% annually, in 2025 Susie will owe \$15 (23.8% of \$61) of tax on the O-Fund investment's capital gain. Susie did not take full advantage of the Opportunity Zone program but nevertheless received a 3.3% effective annual return compared to the 1.5% an equivalent non-O-Fund investment would have delivered.

*Total tax bill in 2025: **\$35***

*After-tax value of investment in 2025: **\$126***

*Effective after-tax annual return on \$100 capital gain in 2018: **3.3%***

Example 3: Investor holds the O-Fund stake for 5 years

As in Example 1, in 2018 Susie rolls over \$100 of capital gains into an O-Fund. She holds the investment for 5 years, selling in 2023. As in Example 1, she can temporarily defer the tax she owes on her original capital gains, but her step-up in basis is only 10%, so that in 2023 she will owe \$21 (23.8% of \$90) of tax on her original capital gains. As in Example 2, Susie enjoys no exemption from capital gains tax on the appreciation of her O-Fund investment, since she holds the investment for less than 10 years. Assuming that her O-Fund investment grows 7% annually, in 2023 Susie will owe \$10 (23.8% of \$40) of tax on the O-Fund investment's capital gain. Susie did not take full advantage of the Opportunity Zone program but nevertheless received a 1.8% effective annual return on her initial capital gains compared to the -0.1% effective annual return an equivalent non-O-Fund investment would have delivered.

*Total tax bill in 2023: **\$31***

*After-tax value of investment in 2023: **\$109***

*Effective after-tax annual return on \$100 capital gain in 2018: **1.8%***

For more information visit eig.org/opportunityzones or email john@eig.org

¹ A qualified Opportunity Fund is a privately managed investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (the vehicle must hold at least 90 percent of its assets in such property). Governors (or the Mayor in the case of the District of Columbia) may designate 25 percent of their state's low-income census tracts as qualified opportunity zones, subject to certification by the U.S. Secretary of the Treasury. Low-income census tracts are defined in Internal Revenue Code Section 45D(d). If the number of low-income census tracts in a state is less than 100, then a Governor may designate a total of 25 tracts. Qualified opportunity zone property includes any qualified opportunity zone business stock, any qualified opportunity zone partnership interest, and any qualified opportunity zone business property. Only taxpayers who roll over capital gains of non-zone assets before Dec. 31, 2026, will be able to take advantage of the special treatment under the provision.