



## Opportunity Zone Program vs. 1031 Exchanges

The Opportunity Zone program is a new investment vehicle created under a provision of the Tax Cuts and Jobs Act of December 2017. The program was developed to encourage investors to invest funds in economically distressed communities thereby stimulating economic development in these areas. When certain funds are invested in these communities, known as Qualified Opportunity Zones (QOZ), investors are able to enjoy immediate as well as eventual tax benefits. Such benefits can include deferral of gain, partial forgiveness of deferred gain and complete forgiveness of certain additional future gains if certain investment criteria are satisfied. On October 19th, the Treasury Department and the Internal Revenue Service issued proposed regulations and other published guidance for the new QOZ tax incentive. The proposed regulations can be found here:

<https://www.irs.gov/newsroom/treasury-irs-issue-proposed-regulations-on-new-opportunity-zone-tax-incentive>

Under the program, investors are able to temporarily defer some capital gains taxes and potentially eliminate certain other future capital gains taxes when they invest their realized gains in a Qualified Opportunity Fund (QOF), which is a corporation or partnership that invests at least 90% of its assets in QOZ property or interests. The realized gains must be invested in a QOF within 180 days of the realization- typically the date of sale of the asset. The QOF may not simply purchase and hold the QOZ property or asset, but must make substantial improvements to that property.

1. **Deferral of gain.** The taxpayer investing in a QOF will be able to take advantage of deferral of capital gains taxes invested until the sooner of December 31, 2026 or when the investor leaves the QOF.
2. **Partial forgiveness of deferred gain.** After holding the funds in the QOF for at least 5 years, the deferred capital gains will receive a 10% reduction, giving the investor a 10% step up in basis. After 7 years, the deferred gains will receive a 15% reduction, allowing for a 15% step up in basis.
3. **Forgiveness of additional gains.** If the investor keeps his funds in the QOF for at least 10 years, any gains accrued by virtue of the appreciation of the QOF will be completely and permanently tax exempt.



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The QOZ program differs from a 1031 exchange in several ways. A 1031 exchange can now only be used with real estate assets – the investor sells investment real estate and trades into replacement investment real estate. With the QOZ program, gain from the sale of any type of asset – real estate, stocks, bonds, etc. - can be placed into a QOF and receive the tax benefits. It is also important to note that the QOZ program requires that the money be placed into the QOF and the QOF then invests in the property. The investor does not invest in the property directly. Because of this, an investor cannot combine a 1031 with a QOZ investment. A QOF is not “like kind” to real estate and would not qualify as replacement property. Similarly, because the QOF is invested in the property rather than the individual, the individual investor cannot 1031 exchange out of a QOZ investment.

As with any tax deferral tool, investors should work with their trusted advisors to determine what vehicle is the best options based on their circumstances.

### Comparison of Opportunity Zone Program and IRC Section 1031 Exchange

	1031 Exchange	Opportunity Zone Program
<b>Eligible asset classes</b>	Only real property held for investment or business purposes	Any
<b>How much needs to be invested</b>	All proceeds for full tax deferral	Only capital gains, in any amount
<b>Investment deadline</b>	180 days	180 days
<b>Where can you invest</b>	Anywhere in the U.S.	Only in QOZ's through a QOF
<b>Is an intermediary required</b>	Yes	No
<b>Tax benefits</b>	<ul style="list-style-type: none"> <li>• Tax can be deferred indefinitely through perpetual exchanges but capital gains fully taxable upon the sale of the final replacement property</li> <li>• Upon death of exchanger, heirs received stepped up basis to the property's market value</li> </ul>	<ul style="list-style-type: none"> <li>• Capital gains deferred until December 31, 2026</li> <li>• OZF investments receive 10% increase in basis after 5 years and 15% after 7 years</li> <li>• Zero capital gains tax on gains from QOF investment after 10 years</li> </ul>



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