How Opportunity Zones Work

Opportunity Zones, created as a result of the passage of the Tax Cuts and Jobs Act, are low-income census tracts eligible to use tax incentives to encourage long-term investments in Zone assets and property. Opportunity Zones are designated as such by the governor or chief executive of a given state, district, or territory. All 50 states, the District of Columbia, and U.S. territories are eligible to designate Opportunity Zones.

Opportunity Zones must be created within "low-income communities," as defined by Section 45D(e) of the Internal Revenue Code (the New Markets Tax Credits Program uses the same definition). In Section 45D(e), "low income communities" are any census tract that have a poverty rate of at least 20 percent, or the median family income does not exceed 80 percent of statewide median family income. If in a metropolitan area, the median family area for such tract must not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income.

As of December 22, 2017, state governors or territory chief executives had 90 days to designate their state or territories' Opportunity Zones. A maximum of 25 percent of a state or territories' low-income census tracts may be designated as Opportunity Zones. If a given state or territory has less than 100 low-income census tracts, it may still designate 25 state Opportunity Zones.

Tax Benefits to Investing in Opportunity Zones

For an investor to realize the tax benefits of investing in Opportunity Zones, an investor's capital gains must be invested in a Qualified Opportunity Fund with 180 days of the sale or exchange that generated the gains. Investors are then eligible to defer the tax on their capital gains until the earlier of: the date the Opportunity Fund investment is sold or December 31, 2026.

The capital gains invested in a Qualified Opportunity Fund are eligible for partial tax forgiveness if the investment is held in a Qualified Opportunity Fund for at least 5 years. After 5 years, only 90 percent of the original gain is taxed. If the investment is held for 7 years, only 85 percent of the original gain is taxed.

If an investment in a Qualified Opportunity Fund is held for 10 years, any tax on the appreciation of that investment is forgiven.

What are Opportunity Funds?

Opportunity Funds are Treasury-certified investment vehicles, that deploy capital into Opportunity Zones. Opportunity Funds are required to hold at least 90 percent of their assets in an Opportunity Zone, or face penalty for each month it fails to meet the investment requirement. The penalty equals the amount of the investment shortfall, multiplied by the underpayment rate as defined in Section 6621(a)(2) of the Internal Revenue Code.