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QOF Investment by December 31, 2021 Required to Maximize Federal Qualified Opportunity Zone Tax Benefits

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December 31, 2021 is the final date for taxpayers to invest in an entity treated as a “qualified opportunity fund” (QOF) and be eligible for all three types of federal income tax benefits available under the qualified opportunity zone (QOZ) program.

Currently, under the QOZ program, three major federal income tax benefits are available to a taxpayer who recognizes capital gain on the sale of property to an unrelated buyer, makes a qualifying equity investment in a QOF up to the amount of that capital gain within a certain period of time (generally 180 days), and holds the QOF equity interest for a specified period:

- 1. Deferral of Capital Gain Recognition.** A taxpayer who invests capital gain into a QOF in compliance with the QOZ rules is not subject to immediate tax on that capital gain. Rather, taxation of that capital gain is deferred, and no federal income tax is required to be paid on the gain, until the end of 2026 (or upon the investor’s disposition of the QOF equity interest, if earlier).
- 2. Reduction of the Deferred Capital Gain.** When a taxpayer is required to recognize their deferred capital gain (i.e., December 31, 2026 at the latest), if they have held their QOF equity interest at least 5 years by that point (i.e., since December 31, 2021 at the latest), then 10% of the resulting federal income tax liability will be eliminated. (Taxpayers who made a qualifying QOF investment on or before December 31, 2019 are also eligible for an additional 5% gain elimination, up to 15% total; however, this benefit is not available for investments made after December 31, 2019.)
- 3. No Federal Tax on Ultimate Sale of QOF Equity Interest.** Any increase in value of a qualifying QOF equity interest that a taxpayer holds for at least 10 years prior to disposition is not subject to federal income tax upon the sale of that QOF equity interest.

Accordingly, taxpayers who make qualifying QOF investments on or before December 31, 2021 have the ability to **eliminate 10%** of the federal tax on their underlying capital gain and to defer payment of the remainder of such tax, as well as to avoid all federal tax on their eventual sale of their QOF equity interest. For QOF investments made after 2021, the ability to eliminate 10% of the tax on the deferred capital gain will no longer be available.

For more information about the requirements and tax benefits of the QOZ program, contact your Vorys tax attorney.