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Double your return in Opportunity Zone investments

The long awaited regulations have been issued that relate to the incentives offered to invest in designated Opportunity Zones (OZ).

Investors are invited to "rollover" realized capital gains into an OZ investment. The tax on that gain will be deferred until tax year 2026 (or earlier if the investment is sold before that). Additionally, if held until 2026, there is a 15% reduction in the gain realized and thus a 15% reduction in the tax that would have been due. Further profits from the investment can be taken tax free if the investment has been held for 10 years or more.

The regulations have made it clear that any capital gains can qualify for the rollover and the 8 year deferral. That includes not just long term capital gains but also short term gains and collectible gains. Up until now the focus had been solely on the reinvestment of long term gains. By investing short term gains, investors can double the tax savings offered by the deferral and 15% reduction in tax.

A \$1,000,000 long term gain gets a reduction in tax of \$30,000. A \$1,000,000 short term gain enjoys a \$55,500 reduction in tax. That is an 85% increase in after tax benefit. Add to that the use of that \$25,500 differential for 8 years and you've easily doubled your benefit by doing nothing more than contributing short term gains instead of long term gains.

Collectible gains that would have been taxed at 28% would also yield more tax benefit than rolling over long term gains. This may be an avenue open to those art investors that have been utilizing Section 1031 rollovers until this year when that process became no longer available to property other than real estate.

Real estate investors that still can utilize Section 1031 and want to continue to invest in real estate should carefully compare and contrast the attributes of Section 1031 and an OZ investment before embracing either. In a 1031 the investor must reinvest the full proceeds of the sale of the property; in an OZ rollover, only the gain has to be reinvested. This can free up a lot of cash for many property investors. On the other hand, a 1031 rollover does not necessitate a tax in 2026 and can offer the possibility of holding until death and a total forgiveness of the gain through the step up in basis. Further, it should be noted that an OZ investment held for less than 10 years does not receive a step up in basis if the investor should pass during that period.

The OZ program holds out some very interesting possibilities that can be optimized only after integrating the investment within the investor's larger tax planning picture.

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