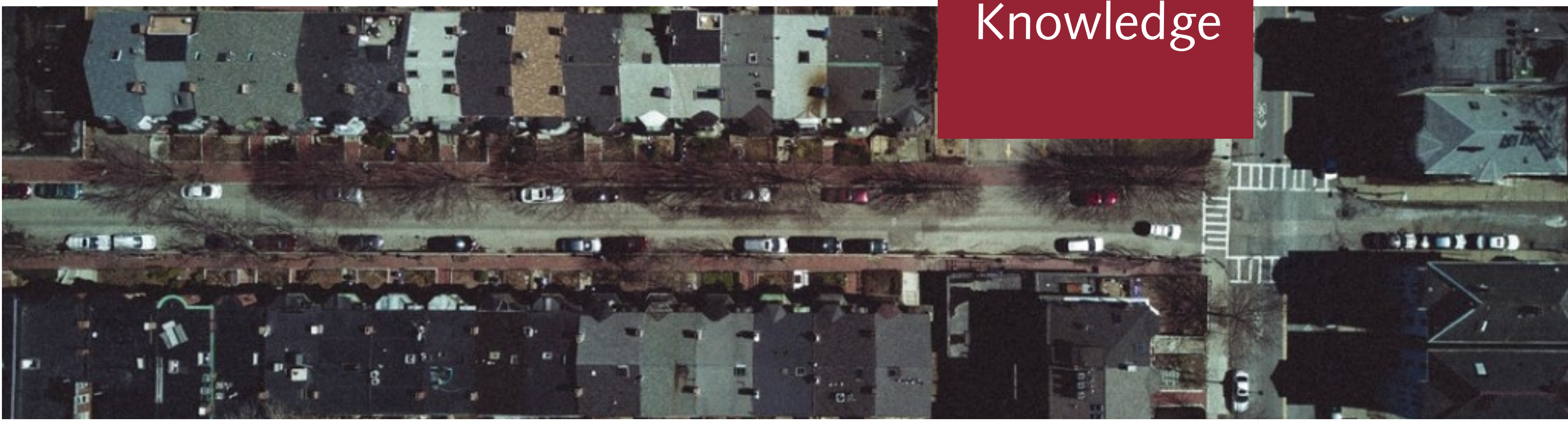
Opportunity Zones & 1031 Exchanges

When an OZ Investment is Generally Advantageous Over a 1031 Exchange

1031 Knowledge



Opportunity Zone (OZ) investments provide three federal income tax benefits for investors. (1) Temporary deferral of taxes on rolled over gains (owed at the end of 2026). (2) Deferred gains invested in an OZ Fund that are held for five years qualify for a 10% reduction of the deferred gain. Deferred gains held for another two years, for a total of seven years, receive a 15% reduction in the deferred gain. At the end of 2026, capital gain taxes are due on the remaining 85% of the deferred gain. Unlike a 1031 exchange, OZ Funds do not allow permanent capital gain deferral. (3) Investors who choose to invest in an OZ Fund and hold for 10 years receive 100% tax exclusion on any new gain within the OZ Fund investment. Section 1031 exchanges provide real estate investors the opportunity to defer taxes when acquiring like-kind replacement property pursuant to the 45/180 day time deadlines.

Some investors want to know which strategy is generally a better approach and the summary below highlights the advantages of Opportunity Zone and 1031 exchange tax strategies:

1. OZ investments **from gains not related to the sale of real property** provide the following tax advantages for investors.
   - An OZ investment can be advantageous for investors selling businesses where some of the sale price consists of significant goodwill and/or personal property since personal property is no longer eligible for Section 1031 tax deferral after TCJA. Investors selling artwork, any personal property, business assets or intangible property will benefit from an OZ.
   - OZ investments provide a new alternative for tax deferral until the end of 2021. Investors have about 2.5 years left to decide to make an investment into an OZ.
   - Both reducing taxes on the deferred gain by up to 15% and pushing the payment of taxes back until the end of 2026, investors can allocate funds that would have been needed to pay taxes now for other investment objectives.

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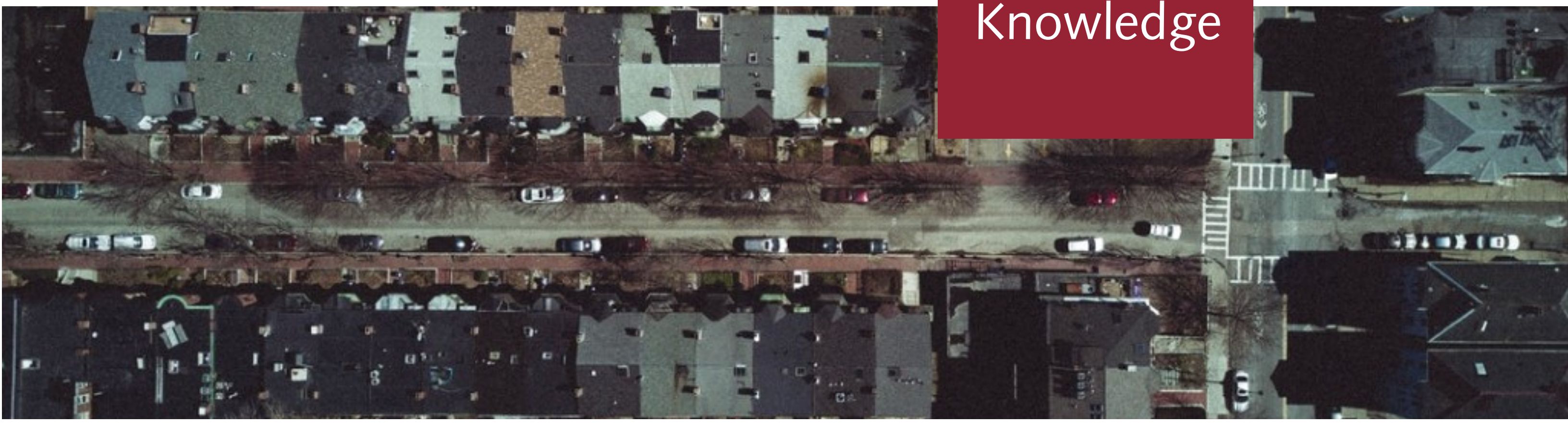

2. For investors **selling real property held for investment**, 1031 exchanges provide significant advantages to OZ:

- **Control:** Unlike an OZ investment in which the investor has little or no control over their investment,1031 exchange investors retain full control over their investment into a replacement property. The investor can choose to do a subsequent 1031 exchange (or a series of 1031 exchanges over time) compared to an OZ investor, who for maximum tax advantages, must hold the investment for at least 10 years.
- **Tax Deferral:** In an OZ, the investor owes taxes on gain at the end of December 2026 (due on April 15, 2027). In a 1031 exchange, taxes are deferred as long as the investor continues to reinvest for full tax deferral in subsequent 1031 exchanges.
- **Flexibility and Timing:** An investor can choose when to pay taxes by selecting the amount and timing of any cash boot or mortgage boot received in a 1031 exchange. OZ rules do not allow for this flexibility and timing.
- **Step-up in Basis:** 1031 exchanges allow for a full step-up in basis to heirs.
- **Real Estate Related Tax Deductions:** A 1031 exchange investor receives all the real estate related tax deductions for owning investment real property. OZ investors do not receive all of these investment property tax deductions directly since they invest money into an OZ Fund, not direct ownership of real property.
- **Opportunity to Refinance:** After a 1031 exchange is complete, an investor can do a cash-out refinance. The IRS has not addressed refinancing related to OZ investments.
- **Sell Assets to Pay Taxes:** Unless an investor has the cash available to pay taxes on 85% of the original deferred gain, they may be forced to sell other assets to generate the cash needed to pay taxes owed at the end of 2026. A 1031 investor does not face this potential liquidity crunch to pay taxes and has more control on the timing of taxes owed.

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