U.S. Energy Development Corporation

(Missed) Opportunity Zones — Don't Wait Until it's Too Late

Many investors, especially those in the qualified or accredited category, are continually looking for investment strategies with attractively positioned tax incentives. For those who haven't yet researched or looked into the full benefits of investing in qualified opportunity zones (QOZs), you may be missing out on three key investment strategies: (1) capital gains deferral, (2) reduction in capital gains owed and (3) tax-free future profits.

Need a real-world example? If an investor earns a profit selling stocks from a portfolio, or the sale of a home or business, the long-term capital gains for most earners is taxed at a rate of 15 percent. This liability must be accounted for and paid by the subsequent annual tax filing deadline (a moving target these days), and could still include a nominal interest penalty. However, if you took the same profits earned through the sale and reinvested them in a qualified opportunity zone, within a six-month time frame, you could defer that 15 percent tax until Dec. 31, 2026. That's over five years from the time of this article!

Opportunity zone investing was a revitalization incentive included in the Tax Cuts and Jobs Act of 2017. At the time, for approximately 8,700 census tracts in the U.S., it was positioned as a win-win opportunity to foster economic redevelopment in historically disadvantaged areas. Thanks in part to a sub-optimal rollout and delayed guidance from the U.S. Treasury Department and the IRS, opportunity zones were slow to catch on with institutional and retail investors alike. Among the first to dip a proverbial toe in the water included real estate and energy development corporations, who traditionally rely on raising capital funds for investment projects.

Yet from an arbitrage standpoint, the benefits of this investment vehicle might be the greatest financial planning tax tool ever. Like many other direct investment organizations, it's advantageous to seek and maintain financial plays that aren't solely judged on what an investor can earn — but also what they can keep. Most qualified opportunity funds (QOFs) combine a competitive rate of return based on early stage cash flow, in addition to the nontraditional tax breaks.

Opportunity zone investments are clearly designed for a long-haul strategy, with incentives in place to hold on to the funds. The longer you remain vested, the smaller your tax burden upon selling. But this benefit only applies to those

who hold the investment for the subsequent time frames by Dec. 31, 2026. If so, the exclusion rate reduction is as follows:

- 5 Years
  10% exclusion on capital gains
- 7 Years
  15% exclusion on capital gains
- 10 Years
  No federal income tax on the appreciation at the date of sale

Has the investment community embraced opportunity zone investing to date? Yes, but not exactly with open arms. Beyond the development of real estate or energy plays, a great deal of the institutional investment community has been slow to explore the remarkable tax deferral and tax-free advantages of opportunity zones. In addition, the strategy does have its share of detractors, who believe that the initial aim of fostering economic improvement hasn't exactly panned out. It's also no secret that many investors may be hesitant because of the uncertainty regarding the current administration's threat to raise the capital gains tax rate. And lastly, more than a few investors are still under the impression that the multi-year tax deferral is the strategy's most attractive feature. It isn't. Opportunity zone investments are tax free for the full life cycle. The long-term returns of compounded wealth are worth much more over time. The only limitation is the amount of capital gains. Some have even compared the dual nature of the tax-deferral and tax-free advantages to a Roth IRA on steroids.

These concerns, as well as the net-worth threshold typically required for opportunity zone investments to pay off, have left more than a few investors on the sidelines. Unfortunately, many still lack the understanding of how this strategy aligns in the full financial, estate and tax planning value chain. Yet, we still remain within the critical window of opportunity to claim these valuable tax deferral and tax-free benefits — which runs through the year 2026.

As long as investors continue to seek strategies that align with a dual benefit — the potential for a high ROI and a decent internal rate of return — opportunity zones should remain an attractive proposition.

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Matthew Iak is the Executive Vice President of U.S. Energy Development Corporation (USEDC), and a member of the company's Board of Directors. Iak has extensive knowledge of private placement, Regulation D, and estate and tax planning strategies. He has led the construction and underwriting of multiple new investment structures in the oil and gas space, which include energy 1031 exchange funds, private capital acquisition funds and, most recently, qualified opportunity zone funds. Since 2005, Matthew has overseen a capital raise of $1.6 billion. USEDC operates an opportunity zone investment fund through various projects in Texas and New Mexico.

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