



Qualified Opportunity Zone Funds Explained:

A Guide for Real Estate Investors



STAX CAPITAL

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What is a **Qualified Opportunity Zone?**

A Qualified Opportunity Zone (QOZ) is an area identified as a low-income community (LIC) based on specific criteria related to income and poverty levels. These zones are designated to encourage investments that promote economic growth and revitalization. A QOZ meets the following conditions:

- ⤵ The poverty rate for the area is at least 20%, or
- ⤵ If located in a metropolitan area and the median family income does not exceed 80% of the area's median family income, or
- ⤵ If outside a metropolitan area and the median family income does not exceed 80% of the statewide median family income.



Each state proposed areas to be designated as QOZs under certain guidelines. Generally, no more than 25% of a state's low-income communities could be designated as QOZs. However, states with fewer than 100 low-income communities were allowed to designate up to 25 zones, even if that exceeded 25% of their total low-income areas.



Understanding QOZs is the first step in exploring how they can serve as the foundation for Qualified Opportunity Funds (QOFs), designed to channel investments into these economically distressed areas while offering tax incentives to investors.

What is a **Qualified Opportunity Zone Fund**?

A Qualified Opportunity Zone Fund (QOF) is a specially created investment vehicle, organized as a corporation or partnership, designed to direct capital into Qualified Opportunity Zones (QOZs). These funds are structured to help revitalize low-income communities by investing in projects that stimulate economic growth.

To qualify as a QOF, a fund must meet the following key criteria:

- ① **Investment Requirement:** The fund must invest at least 90% of its assets into Qualified Opportunity Zone Business Property (QOZBP). This investment requirement is assessed at specific points—on the last day of the fund’s taxable year and at the six-month mark within that year.
- ② **Working Capital Compliance:** Cash investments held within the QOF can count towards the 90% requirement if certain conditions are met. The fund must:
 - Have a written plan identifying the working capital as reserved for acquiring, building, or significantly improving property in a QOZ.
 - Maintain a written schedule showing the working capital will be utilized within 31 months
 - Ensure the business adheres to this plan, known as the "Working Capital Safe Harbor," which facilitates multi-year development projects while staying within compliance.

QOFs offer an innovative way for investors to participate in economic development while benefiting from potential tax advantages, helping both communities and investors achieve growth and revitalization.

Potential Tax Benefits **Available** to a **QOF Investor**

Investing in a Qualified Opportunity Zone Fund (QOF) provides investors with unique tax benefits designed to encourage reinvestment in economically challenged areas. Here's a breakdown of the potential tax incentives for QOF investors:

- **Tax Deferral:** When you invest capital gains from the sale of any asset into a QOF within 180 days, you can defer the tax on those gains until December 31, 2026. At that time, the tax will be assessed on the lesser of the original invested gain or the fair market value of your QOF investment as of that date.
- **Tax-Free Growth:** If you hold your investment in the QOF for at least 10 years, any capital gains earned from the appreciation of the QOF investment are entirely tax-free. This means that after a decade, any growth in the value of your investment is exempt from capital gains tax, maximizing your potential returns.



QOF Investment Timeline

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- **Capital Gain Realization:** Investors have 180 days from the recognition of capital gains to reinvest in a QOF. This timeline ensures eligibility for deferring tax obligations.
- **Deferral Period:** Capital gains invested in a QOF are deferred until December 31, 2026, or until the investment is sold, whichever comes first.
- **10-Year Benefit:** For investments held for at least 10 years, the basis in the QOF investment is stepped up to fair market value, eliminating capital gains tax on any appreciation.



Note: These timelines must be strictly followed for investors to qualify for tax advantages. Always consult with a tax advisor to confirm compliance with IRS guidelines and to understand the implications for your specific situation.

QOF Investment Deadline

When investing in a Qualified Opportunity Fund (QOF) to take advantage of tax deferral benefits, investors must be aware of the following deadlines:

Capital Gains Recognized by Individuals: If you have realized capital gains, you must invest those gains (either in full or in part) into a QOF within 180 days of recognizing the gain. This 180-day period may extend across different calendar years.

Capital Gains from Pass-Through Vehicles: If your capital gains are realized and distributed through a pass-through vehicle (e.g., partnerships, LLCs), you must also invest these gains into a QOF within 180 days. However, you have the option to start this 180-day investment window on one of the following dates:

- ① The date of the sale or gain recognition.
- ② The last day of the pass-through vehicle's taxable year (e.g., December 31 for entities with a calendar year-end), especially if the gain is reported on a Schedule K-1.
- ③ The due date for the pass-through vehicle's tax return (e.g., March 15 for those with a calendar year-end).

Who Typically Invests in QOFs?

Qualified Opportunity Zone Funds (QOFs) can be an effective tool for investors looking to defer taxes and enhance their financial planning. Below are common investor profiles that may benefit from QOFs:

Securities Sale

- ① Investors re-balancing a portfolio with significant capital gains or selling concentrated positions may find QOFs beneficial.
- ① Investing in a QOF can potentially provide tax-free growth (if held for at least 10 years) and tax-advantaged income.
- ① Allows reallocation of the basis and any portion of capital gains not invested in a QOF.

Business Sale

- ① Provides an opportunity to spread a potentially large tax liability over multiple periods.
- ① Enables proactive tax planning by deferring capital gains.
- ① Creates capital that may potentially grow tax-free and generate tax-advantaged income over time.

Retirement Planning

- ① QOF strategies that focus on development followed by a stable holding period often target tax-advantaged growth and income.
- ① Allows investors to sell an appreciated asset from a taxable account and reinvest the capital gain into a QOF for potential tax-free growth and income.

Important Risk Factors

Investing in a Qualified Opportunity Zone Fund (QOF) comes with significant risks that need to be carefully considered. These include:

- **Compliance Requirements:** To qualify for the tax benefits of a QOF, investors must meet various requirements outlined in Sections 1400z-1 and 1400z-2 of the U.S. Internal Revenue Code, as well as guidance from the U.S. Treasury and IRS. Failure to comply or if the fund does not meet QOF qualifications may result in the loss of all or part of the associated tax benefits. Always consult a tax professional to understand your specific tax implications.
- **Limited Liquidity:** QOF interests are typically not traded publicly, and a public market may never develop. This means that QOF investments are generally illiquid.
- **Transfer Restrictions:** QOFs usually sell interests under exemptions from federal and state registration laws, which means these interests come with restrictions on transferability.
- **No Guarantee of Investment Objectives:** There is no assurance that a QOF will achieve its investment goals or objectives.
- **Real Estate Risks:** Real estate investments come with various risks, such as local market conditions, oversupply or reduced demand, difficulties in rent collection, vacancies, inflation, rising operating costs, legal changes affecting property owners, and shifting market demographics.
- **Uncertain Distributions:** The timing and amount of distributions from a QOF are not guaranteed and may vary. Investors might not receive regular distributions or a return of their initial capital.
- **Tenant Dependence:** QOFs that invest in rental properties rely on tenants for revenue. Financial difficulties, bankruptcy, or insolvency of tenants can have negative impacts on fund performance.

- ③ **Economic and Financial Market Risks:** Economic downturns and disruptions in financial markets could adversely affect a QOF's performance.
- ③ **State-Level Limitations:** Tax benefits associated with QOFs may not be available under state law, and some states may have additional requirements for equivalent benefits.
- ③ **Speculative Nature:** Investing in a QOF is highly speculative and involves significant risk.

Before investing, potential investors should thoroughly review the fund's offering memorandum for a comprehensive description of the associated risks and disclosures.



STAX CAPITAL

10525 Vista Sorrento Pkwy, Suite 220, San Diego,
CA 92121

info@staxai.com | 844.427.1031

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