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Pairing a Long/Short SMA with an Opportunity Zone Fund

OBBBA Permanent Rules · Tax-Efficient Redeployment · Loss Harvesting Offset

Illustrative Case Study: $2 Million Portfolio | Q1 2027 Investment

This case study models a $2 million portfolio split equally between a Qualified Opportunity Fund (QOF) and a 130/30 Long/Short SMA — redeploying proceeds from a concentrated stock position in Q1 2027 under the permanent Opportunity Zone rules established by the One Big Beautiful Bill Act. The combination produces three compounding tax advantages: deferral and elimination of the capital gain, ongoing tax alpha from the SMA, and SMA loss harvesting that — at the 4.41% annual tax alpha documented for 130/30 strategies — fully eliminates the deferred capital gain at the 5-year mark. **The result: a $238,000 deferred tax bill reduced to $0, a $2M portfolio that grows to approximately $6M by Year 10 — with tax-free appreciation and no depreciation recapture on exit.**

Three Outcomes at a Glance

Tax-Efficient Redeployment	Year 5 ◆ $0 Deferred Tax Bill	Year 10 ~$6M Portfolio
OZ Fund + 130/30 SMA. Concentrated stock gains redeployed into complementary tax-advantaged vehicles — deferral + elimination on one side, ongoing tax alpha on the other.	SMA losses + OBBBA step-up fully eliminate the $238K deferred capital gain at the 5-year mark.	Tax-free appreciation at exit + no depreciation recapture + compounded SMA growth from a $2M starting position.

Portfolio Structure & Assumptions

Portfolio Structure	Tax Strategy Mechanics
Total Capital: $2,000,000 (proceeds from concentrated stock position) OZ Investment: $1,000,000 capital gain → QOF, Q1 2027 SMA Investment: $1,000,000 cost-basis → 130/30 Long/Short SMA **Return Assumptions** OZ IRR: 10% SMA Annual Return: 12% Tax Rate (LTCG + NII): 23.8%	SMA Annual Tax Alpha: 4.41% = $44,100/yr[1] Annual Losses Harvested: ~$185,294/yr on $1M SMA Savings Years 1–5: Stored to offset OZ deferred gain Savings Year 6+: Reinvested — accelerates SMA compounding 5-Year Cumulative Losses: ~$926,471 Optional Year 4 Refi: $300k–$400k tax-free distribution[2] OBBBA Basis Step-Up: 10% at Year 5 — reduces taxable gain $1M → $900k Deferred Tax Due: Q1 2032 (5-year rolling deferral under OBBBA)

Projected Growth

The 130/30 SMA harvests losses on both the long and short book. At the 4.41% annual tax alpha documented for these strategies[1], that generates roughly $185,000/yr in losses on a $1M portfolio — equivalent to $44,100/yr in tax savings stored against the future OZ gain bill.

Year	OZ Investment (10% IRR)	Refi Dist.	SMA Value (12%)	Portfolio Total	SMA Savings
Year 0 (Q1 2027)	$1,000,000	—	$1,000,000	$2,000,000	
Year 1 (2028)	$1,100,000	—	$1,120,000	$2,220,000	$44,100 saved
Year 2 (2029)	$1,210,000	—	$1,254,400	$2,464,400	$88,200 saved
Year 3 (2030)	$1,331,000	—	$1,404,928	$2,735,928	$132,300 saved
Year 4 ★ (2031)	**$1,464,100**	**$300k–$400k**	**$1,573,519**	**$3,037,619**	**$176,400 saved**
Year 5 ◆ (2032)	**$1,610,510**	—	**$1,762,342**	**$3,372,852**	**$220,500 → $0 tax**
Year 10 (2037)	**$2,593,742**	—	**$3,419,628**	**$6,013,370**	**Savings reinvested**

★ Year 4: Refi proceeds are debt, not income — no tax triggered. OZ holding period and full $1M balance continue unaffected.

◆ Year 5: Accumulated losses exceed the $900k taxable gain after step-up. Tax bill: $0. Savings reinvested from this point, boosting Year 10 SMA by ~$310k.

Year 5 (Q1 2032): Why the Tax Bill Reaches Zero

Three mechanisms stack at Year 5 to eliminate the deferred gain:

	Without SMA	With 130/30 SMA[1]
Original Deferred Gain	$1,000,000	$1,000,000
10% OBBBA Basis Step-Up	($100,000)	($100,000)
Taxable Gain After Step-Up	$900,000	$900,000
5-Year SMA Losses (~$185k/yr)	—	($926,471)
Net Taxable Gain	**$900,000**	**$0**
Tax Owed @ 23.8%	**$214,200**	**$0**

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Tax Timeline

Year	What Happens
Q1 2027 (Year 0)	Invest $1M capital gain into QOF. Invest $1M cost-basis into 130/30 Long/Short SMA. SMA begins harvesting losses immediately — roughly $185,000/yr. Tax savings ($44,100/yr) are set aside, not reinvested.
2028–2031 (Years 1–4)	OZ compounds at 10% with no tax recognition event. SMA grows at 12%. Harvested savings accumulate each year. By end of Year 4: $176,400 stored.
Year 4 ★ (2031)	QOF refinances its underlying real estate. Investor receives $300k–$400k in cash from debt proceeds — no income tax triggered. The 10-year holding period clock continues uninterrupted.[2]
Year 5 ◆ (Q1 2032)	5-year deferral ends. OBBBA 10% basis step-up reduces taxable gain to $900k. Accumulated SMA losses (~$926k) exceed the $900k amount — tax bill is $0. Savings begin reinvesting into SMA.
2033–37 (Years 6–10)	$44,100/yr in savings now compounds inside the SMA. OZ investment continues toward a tax-free exit at Year 10.
Year 10 (2037)	OZ exit: all appreciation above the original $1M is tax-free. No depreciation recapture. SMA has grown to ~$3.42M. Combined portfolio: ~$6M.

Strategic Takeaway

5-Year Rolling Deferral: A 2027 investor gets the same 5-year runway early TCJA investors received in 2018 — versus only ~1 year under OZ 1.0 (2025). More time to accumulate losses and stage capital before the tax bill arrives.

Tax-Efficient Redeployment: Rather than holding a concentrated position or paying tax to diversify, the investor redeploys gains into two complementary tax-advantaged vehicles. The OZ fund defers and ultimately eliminates the capital gain; the 130/30 SMA generates 4.41% annual tax alpha that offsets the remaining liability.

SMA Loss Harvesting Eliminates the Gain: At the academic benchmark for 130/30 strategies[1], five years of harvested losses exceed the taxable gain after the OBBBA step-up. The investor pays $0 in deferred capital gains tax — and $220,500 in stored savings begins compounding inside the SMA from Year 6.

Year 10 Outcome: ~$6M gross portfolio with tax-free OZ appreciation at exit and no depreciation recapture. From a $2M starting position — $0 in deferred capital gains and $0 in depreciation recapture.

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Appendix: OBBBA Program Changes Reference

Program Duration:	OZ is now permanent law. Current QOZ designations expire 12/31/2026; new zones take effect 1/1/2027.
Rolling 5-Year Deferral:	Post-2026 investors defer tax for 5 years from investment date — not a fixed 12/31/2026 deadline.
Basis Step-Up:	Flat 10% at Year 5. The prior 15% at 7 years has been eliminated under OBBBA.
10-Year Exclusion:	All appreciation above the original investment is tax-free at exit if held 10+ years.
QROF (Rural):	Qualified Rural Opportunity Funds in areas under 50,000 population receive a 30% basis step-up — potentially superior structure.

[1] *Goldberg, Lisa R., Taotao Cai, and Ben Schneider. "A Guide to 130/30 Loss Harvesting." Journal of Asset Management 25, no. 5 (2024): 445–459. The 4.41% figure is average pre-liquidation tax alpha for a cash-funded 130/30 portfolio, back-tested June 1995–June 2023. Actual results vary by manager, benchmark, and market conditions.*

[2] *Refinancing proceeds are debt, not income, and do not trigger a recognition event under current QOF rules. However, distributions in excess of the investor's basis in the QOF interest may be treated as a partial inclusion event. Confirm treatment with qualified tax counsel prior to refinancing.*

Disclaimer: This document is for educational purposes only. Pinnacle Partners does not offer legal, investment, tax, or other professional advice. Tax rules reflect the One Big Beautiful Bill Act (P.L. 119-21) as signed July 4, 2025. Consult qualified tax advisors before taking action.