

OBBBA CHANGES TO THE QUALIFIED OPPORTUNITY ZONE PROGRAM

Sharon Shachar

**Ballard
Spahr**
LLP

SUMMARY OF PRE-OBDBA OPPORTUNITY ZONE INCENTIVES

• Opportunity Zones Generally

- The Tax Cuts and Jobs Act of 2017 created an opportunity for taxpayers to defer and partially eliminate capital gains by making long-term investments in “qualified opportunity funds” (“QOFs”) investing in economically depressed areas designated as “qualified opportunity zones” (“QOZs”).
- A QOF must satisfy certain asset requirements by investing in qualifying assets within designated QOZ census tracts that meet defined income thresholds and that were selected by the states and territories in which the tracts are located.
- The QOZ provisions were designed to encourage direct investment (and accompanying employment and economic stimulus) in a wide range of businesses in economically depressed areas, including affordable housing and other real estate related projects as well as operating businesses.

• Tax Incentives Available

- **Temporary deferral:** In the original program, eligible gains rolled into a QOF are deferred until the earlier of December 31, 2026 or the date of an “inclusion event” with respect to the taxpayer’s investment in the QOF.
- **Elimination of portion of deferred gain:** Initially, the QOZ program provided a basis step-up (10% or 15%) if gains were invested by certain dates and held for a certain period (7 years – 15% and 5 years – 10%), meaning that portion of the deferred gain would not be subject to tax.
 - Based on the required holding period, these benefits were only available for investments made by December 31, 2021 or December 31, 2019, respectively
- **Exclusion of gain on post-acquisition appreciation:** If an investment in an original QOF is held for at least 10 years, the taxpayer may recognize no gain on the post-acquisition appreciation in its QOF interest through 2047.
- **State Tax:** Note that not all states follow the federal law and thus gains may be subject to State tax

KEY CHANGES TO THE QOZ PROGRAM

Provision	Current Law	OBBBA
Opportunity Zone Designation & Renewal	<ul style="list-style-type: none"> All current QOZs would have expired December 31, 2028. 	<ul style="list-style-type: none"> Current QOZs still expire December 31, 2028 (although gain currently deferred in QOFs still must be recognized on December 31, 2026). New QOZs may be designated every 10 years. The next designation process will begin July 2026, for investments beginning January 1, 2027.
Opportunity Zone Eligibility	<ul style="list-style-type: none"> QOZ median income must not exceed 80% of the area or statewide median income. Adjacent census tracts that did not meet this requirement could be designated. 	<ul style="list-style-type: none"> Reduces income threshold to 70%. Does not allow for designation of adjacent census tracts.
Deferral of Capital Gains	<ul style="list-style-type: none"> Deferred capital gains must be recognized no later than December 31, 2026. 	<ul style="list-style-type: none"> Deferred capital gains recognized every 10 years.
Basis Step Up	<ul style="list-style-type: none"> Investments before December 31, 2019 eligible for a 15% step up. Investments before December 31, 2021 eligible for a 10% step up. No step up for investments after 2021. 	<ul style="list-style-type: none"> Generally, 10% step up after hold period of 5 years. 30% step up after 5 year hold period for investments in “qualified rural opportunity funds” (“QROFs”)
Exclusion of Post-Investment Appreciation	<ul style="list-style-type: none"> Full exclusion after 10 year holding period. Applies until 2047. 	<ul style="list-style-type: none"> Preserved. Rolling 30-year cap.
“Substantial Improvement Test”	<ul style="list-style-type: none"> Non-“original use” property must be improved by 100% of its adjusted basis within 30 months. 	<ul style="list-style-type: none"> Same, except that a lower, 50% standard applies to QROF projects.
Compliance & Reporting	<ul style="list-style-type: none"> Minimal reporting and enforcement. No public data reporting. 	<ul style="list-style-type: none"> Detailed annual reporting from QOFs and QOZ businesses. Penalties for reporting noncompliance. Publication of data by Treasury annually.

KEY CHANGES TO THE PROGRAM

The OBBBA made the following changes to the original program established by the TCJA:

- **Opportunity Zone Designation & Renewal**

- The OBBBA makes the QOZ program permanent, on a rolling basis, replacing the original sunset provision.
- Wkhvh#Exuhqw#R] #ghvjgdwlrqv# l#hp dlq#q#dfh#k#urxjk#kh#hg#r i#53591
- New QOZs will be designated every 10 years (“decennial determination”), with the first new designations effective January 1, 2027.
- Each round of QOZ designations will last for 10 years, after which states will re-nominate eligible tracts.

- **Stricter Eligibility Criteria for Opportunity Zone Designation**

- The definition of “low-income community” (a necessary criterion for a QOZ designation) was narrowed:
 - If the designation is based on median family income, the median family income threshold must be no more 70% of the area or statewide median (reduced from 80%)
 - If the designation is based on a poverty rate of at least 20%, there is now an additional requirement that the median family income in the census tract must be no more than 125% of the area or statewide median
 - Census tracts contiguous to low-income communities are no longer eligible for QOZ designation
- All will result in reducing the number of tracts that qualify

KEY CHANGES TO THE PROGRAM

• Changes to Tax Benefits and Investment Requirements

– Deferral of Capital Gains:

- For investments made after December 31, 2026, deferred gains are recognized on the earlier of (a) the date the investment is sold or exchanged, or (b) five years after the investment is made (rolling five-year deferral).
- For investments made before January 1, 2027, the original rules apply, with recognition required by December 31, 2026.

– Basis Step-Up:

- The step-up in basis for deferred gains is now 10% after five years (eliminating the previous 15% maximum).
- For investments in QROFs, the basis step-up is increased to 30% after five years.

– Exclusion of Post-Investment Appreciation:

- The exclusion of capital gains on appreciation after a 10-year hold remains, but with a new cap:
 - If the investment is sold before the 30th anniversary, basis is stepped up to fair market value at sale.
 - If sold after the 30th anniversary, basis is stepped up to the fair market value as of the 30th anniversary, and any further appreciation is taxable.

KEY CHANGES TO THE PROGRAM

- **Enhanced Focus on Investments in Rural Areas**
 - A new category of QOF, Qualified Rural Opportunity Funds (“QROFs”), was created.
 - QROFs must hold at least 90% of their assets in the form of qualified opportunity zone business property (“QOZBP”) used primarily in a QOZ comprised entirely of a “rural area.”
 - For this purpose, a “rural area” is any area other than:
 - a city or town with a population of 50,000 or more or
 - any urbanized area contiguous and adjacent to such a city or town.
 - The “substantial improvement” requirement for QOZ property in rural areas is reduced from 100% to 50% of the adjusted basis, lowering the investment threshold for rehabilitation projects in rural areas.
 - In recent notice, the IRS provided guidance as to how to apply this test to the existing 2018 QOZs and identify in Exhibit the rural areas under the existing zones (Notice 2025-50).
 - Investors in QROFs may receive a 30% basis step up if their investment is held for more than 5 years.
 - At least 33% of new QOZ designations in each state must be comprised entirely of rural areas (or all eligible rural areas if less than 33% of total eligible areas).

KEY CHANGES TO THE PROGRAM

- **New Compliance and Reporting Requirements**

- QOFs and QOZBs must file detailed annual reports, including information on value and type of property owned/leased, number of residential units (if applicable), average number of full-time equivalent employees or other employment impact metrics.
- QOZBs must provide information to QOFs to facilitate compliance.
- The Treasury Department is required to publish annual public reports on the program, including investment amounts, types of projects, and economic impacts (e.g., job creation, poverty reduction).
- Penalties for non-compliance are increased, with higher penalties for larger funds.

- **Timelines and Transition**

- Gain recognition for investments in current QOFs remains scheduled for December 31, 2026
- Most of the OBBBA provisions take effect after December 31, 2026
 - New QOZ designations will take effect January 1, 2027, and last for 10 years.
- Investors must carefully consider the timing of investments in late 2026, as there may be a “dead zone” where new investments cannot qualify if the tract is not re-designated.
- The substantial improvement threshold for rural areas took effect on July 4, 2025 (Notice 2025-50 list the current rural zones).

KEY CHANGES TO THE PROGRAM

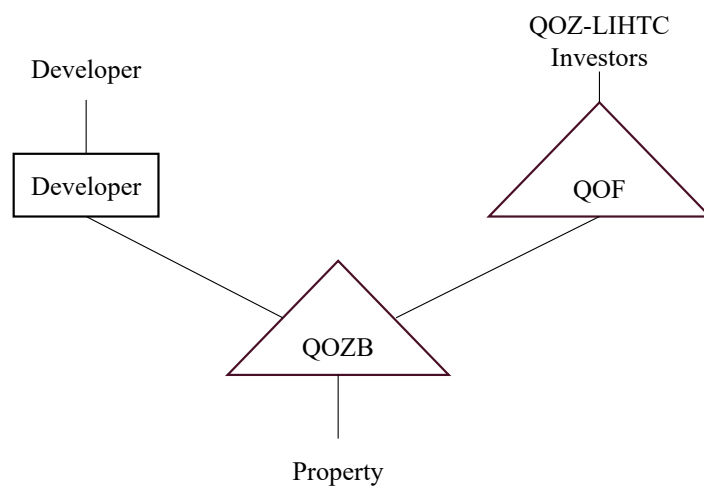
- **What Didn't Change**

- The program otherwise continues to restrict benefits to capital gains.
- Fund-of-funds structures remain prohibited.
- No additional or enhanced incentives for affordable housing or operating businesses were included.

- **Open Items – waiting for further guidance**

ISSUES AND OPPORTUNITIES FOR QOZ AND LIHTC

- **Typical QOZ-LIHTC Structure**



- **Key QOZ-LIHTC issues and opportunities**