OPPORTUNITY ZONES | NOVEMBER 11, 2026

Treasury and IRS Announce Opportunity Zone Designations for Over 6,500 Communities Across America

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The U.S. Department of the Treasury and the Internal Revenue Service announced the Qualified Opportunity Zone (QOZ) designations for all 50 states, territories, and the District of Columbia. In total, 6,576 eligible census tracts were nominated, of which 2,594 are in rural areas which may entitle investors to enhanced benefits. According to Treasury, all of the 6,576 eligible census tracts have been designated as QOZs effective January 1, 2027.

Transition Guidance

Because the new opportunity zone map differs from the current (pre-2027) map, there is a pressing need for Treasury guidance on how the new designations interact with the pre-2027 designations, and how the new designations affect current opportunity zone projects.

The IRS has signaled its intention to issue proposed regulations containing transitional guidance related to the original Qualified Opportunity Zone program (QOZ 1.0) and the new, post-OBBBA QOZ program (QOZ 2.0). The IRS issued Notice 2026-40 (the "Notice"), which previews forthcoming proposed regulations. Some of the key provisions in the Notice are summarized below. For current QOF projects, it is important to anticipate the forthcoming rules especially for projects that are in-process, and ensure planning is done before the end of 2026 in order to meet the QOZ requirements.

In addition, the IRS also issued Notice 2026-55, which requests general comments on tax issues arising under the provisions of QOZ 2.0, including soliciting comments on the application of the qualified opportunity zone program to businesses selling single-family homes.

<u>Required Inclusion of Gain in 2026, But Investment Remains Eligible for the 10-Year Election.</u>

Investors holding a qualifying QOZ investment on and through December 31, 2026, are required to include in income the amount of remaining deferred gain from the qualifying investment. The IRS calls this amount the "deemed included gain." This deemed included gain cannot be further reinvested on a deferred basis under the

QOZ program. However, the Notice confirms that investors that recognize this deemed included gain on December 31, 2026, can continue to hold the qualifying investment which remains potentially eligible to make the 10-year election on the later sale or exchange of that qualifying investment. In other words, investors must recognize the remaining deferred gain in their QOZ investments in 2026, but provided they continue to hold the investment for at least 10-years, they would still be eligible to make the 10-year election upon sale or exchange to essentially exclude post-investment gains.

Gain Realized in 2026 may be Invested in 2027.

Investors may realize capital gains in the second half of 2026. If these investors seek QOZ benefits, they need to decide whether to reinvest in 2026 (in QOZ 1.0) or in 2027 (in QOZ 2.0). The requirements and tax benefits differ between the two programs. The Notice confirms that in the case of an investor with eligible gain realized on, before, or after December 31, 2026, who timely invests a corresponding amount in a QOF on or after January 1, 2027, the investor may elect to defer the recognition of that gain provided they meet the general requirements, including the 180-day deadline. This confirms that investors indeed have much needed flexibility to either invest under QOZ 1.0 in 2026 or under QOZ 2.0 in 2027, provided they meet all of the other requirements.

Inclusion Event Gain is Eligible for Reinvestment.

Certain inclusion events (e.g., certain types of sales, gifts, dispositions) cause previously deferred gains to be included in an investor's income. The Notice confirms that an investor may reinvest its gain triggered from an inclusion event into a QOF provided that all of the other requirements to elect to defer gain are met. However, this would be treated as a new investment into a QOF, and the 10-year holding period would essentially restart.

Property acquired after 2026.

For many existing QOFs and QOZBs that are still in the development phase or that are operating prior to the end of 2026, additional property may need to be acquired in 2027 or later years. This additional property generally cannot be qualifying property (i.e., QOZBP) unless the property is acquired for use in a QOZ that is designated after July 4, 2025 (i.e., a 2027-cycle designated QOZ), or one of the two following conditions are met:

> (1) *Working Capital Safe Harbor Exception*. If an entity acquires property after 2026, for use in a previously designated QOZ pursuant to a Working Capital Safe Harbor, then that property may satisfy the acquisition requirement if (i) the working capital plan was adopted on or before December 31, 2026, (ii) the relevant property acquisitions are made in a manner substantially consistent with that plan, (iii) the QOZB has received at least 10% of the total estimated working capital assets designated in writing pursuant to the plan by December

31, 2026, and (iv) the QOZB expends at least 5% of the total estimated working capital assets by December 31, 2026. Amounts required to be expended by a QOZB pursuant to a binding agreement entered into prior to January 1, 2027, will be considered to be expended for purposes of the 5% requirement.

(2) *Replacement or Modernization Exception*. Tangible property acquired after 2026 by a QOF or QOZB for use in the ordinary course of its trade or business in a previously designated QOZ to replace existing tangible business property may be treated as QOZBP. Replacements in the ordinary course of a trade or business include the *replacement or modernization* of property necessary to continue the operations of the trade or business. Replacements in the ordinary course of a trade or business do not include tangible property acquired pursuant to the expansion of a trade or business or the transition of a trade or business into a new trade or business.

The Notice contains several examples of these last two exceptions. Current QOF projects must anticipate the coming rules, especially those that are not in re-designated opportunity zones under the QOZ 2.0 program. In those cases, the working capital share harbor exception or replacement or modernization exemption should be carefully followed pending further guidance. While the Notice is simply preliminary, interim guidance, it does indicate how Treasury is thinking about formulating the forthcoming proposed regulations.



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