

OPPORTUNITY ZONES | AUGUST 4, 2025

Opportunity Zones after OBBBA - Old Zones Left to Expire, New Zones

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The One Big Beautiful Bill Act signed by President Trump on July 4, 2025 (the "OBBBA") creates a new round of qualified opportunity zones ("QOZs"), with potential new QOZs to be designated every 10 years.

I. Low Income Communities Redefined

While the process for designating new QOZs is the same (meaning the chief executive officer (e.g., the Governor) of a state makes the nomination, subject to final designation by the Treasury Secretary), there are tighter requirements on which areas meet the definition of a "low-income community." Under the new QOZ program, a low-income community is generally a population census tract with a median family income of 70% or less of the baseline state or metropolitan area median family income (down from 80% under the current QOZ program), or with a poverty rate of at least 20% and a median family income that does not exceed 125% of the baseline state or metropolitan area median family income.

There are also now rural QOZs which generally provide investors with enhanced tax benefits for investments in those areas. A rural area is defined as any area other than a city or town with a population of over 50,000 (and any urbanized area adjacent thereto).

Observations

As 2027 approaches, industry players should begin to finalize their plans with regard to investments in the original QOZ program, ensuring eligible gains are invested before the applicable timeframe expires. Once an investor makes a timely qualifying investment, the 10-year basis election under the original program is generally permitted until December 31, 2047. Investors who wish to benefit from the current program (for example, by being able to make the basis step-up election after a 10-year holding period) generally must still re-invest gain that otherwise would be recognized no later than December 31, 2026.

It is also time to gear up for the new round of QOZ designations. Investors should begin to study the census tract maps to determine

potential new QOZs under the revised definition of “low income community,” and consider how the existence of the current QOZ designations could interact or overlap with new QOZ designations.

Investors may also now look to rural areas for increased tax benefits. A rural area is any area other than an area with over 50,000 inhabitants (and “urbanized” adjacent areas). While determining cities or towns with over 50,000 inhabitants may be somewhat mechanical, determining what constitutes a contiguous “urbanized area” may be more open to interpretation.

II. Tax Benefits Modified

The new tax rules applicable to new QOZs will apply with respect to amounts invested in a qualified opportunity fund (a “QOF”) after December 31, 2026.

For the most part, the new QOZ tax rules are the same as the existing rules. However, several key differences exist, such as: (a) income tax deferral of reinvested gain is permitted for only up to 5 years; (b) after a 5-year holding period, the investor will be entitled to a 10% basis increase (30% in the case of a qualified “rural” opportunity fund); (c) the “substantial improvement” requirement is eased in the case of investments in rural area zones, requiring the “addition to basis” (e.g., improvements) to exceed only 50% of the original adjusted basis; and (d) the election to increase basis to fair market value upon sale or exchange after a 10-year holding period is still available, but sales or exchanges after a 30-year holding period are only eligible for the adjustment to the fair market value as of the 30-year anniversary.

Observations

For the new round of QOZs, the rules of the game are much more developed than in 2018, when taxpayers had to wait years for multiple rounds of proposed and final regulations to be issued by Treasury before having confidence in the intended tax results of their investments. As a result, the new QOZ program should get off to a more auspicious start. Some of the prior tax incentives have been trimmed back. For example, deferral is only permitted for up to 5 years, and there is only one basis adjustment of 10% after a 5-year holding period (as opposed to the prior rules where there was an additional 5% basis increase after a 7-year holding period). In addition, for investments held for 30 years or more, the basis increase is only as of the 30-year anniversary, thus potentially capping the basis increase at the value on the 30-year mark, even if the investment is held for much more than 30-years.

On the other hand, the new tax rules clearly incentivize rural area investments by supercharging the basis adjustment to a potential 30% after 5-years, and reducing the amount needed to be invested under the substantial improvement test.

New and Modified QOZ Reporting

Finally, the OBBBA imposes new reporting and filing requirements for QOFs. New penalty provisions were also passed.

Filing Requirements

A new provision requires every QOF to file an annual return in electronic form containing information about the entity, its investments and the names of any persons who disposed of interests in the QOF. It also requires the QOF to provide written statements to certain investors who disposed of QOF interests. Another new provision requires every QOZB (qualified opportunity zone business) to provide a written statement to its respective QOF containing certain information that would enable the QOF to satisfy its reporting obligations.

Penalties

A new penalty provision was also enacted which provides that if a QOF fails to comply with its return filing requirement, it is subject to a penalty of \$500 per day (up to a maximum of \$10,000 for QOFs valued at \$10 million or less, or a maximum of \$50,000 for QOFs whose value exceeds \$10 million). Penalties are increased for intentional disregard and are inflation adjusted.

Observations

The new reporting provisions provide the statutory underpinning for QOF reporting, despite the current use of IRS Form 8996 by QOFs for their initial certification and annual reporting. The statutory requirement for electronic filing, however, may require QOFs to change the way in which returns are filed. In addition, a penalty framework is now enshrined in statute, which puts more pressure on QOFs to meet their filing requirements.

We would be happy to discuss the multifaceted issues surrounding QOZs or any of the above comments and observations. Do not hesitate to reach out to us with your QOZ needs.



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