Opportunity Zones
WORKING GROUP™
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February 4, 2026

U.S. Department of the Treasury
Attn: Kevin Salinger
Deputy Assistant Secretary for Tax Policy
Washington, D.C. 20044

Re: Opportunity Zones - Implementation Guidance Recommendations

Dear Deputy Assistant Secretary Salinger:

The Novogradac Opportunity Zones Working Group (the "OZ Working Group"), is submitting the attached recommendations for Treasury as it implements the One Big Beautiful Bill Act's opportunity zones (OZ) provisions. This recommendation letter is the second of several that we intend to submit and focuses on topics for which guidance is needed to maximize investment in low-income communities. These topics include identifying eligible census tracts, implementing reporting requirements, determining penalties for failure to comply with reporting requirements, and the ability to defer gains from 2026 inclusion events.

We have also attached the letter we previously submitted on October 28, 2025 that details our recommendations for immediate guidance including the approaching expiration of current OZ designations, clarification of the effective date of the lower substantial improvement threshold for investments in rural property, and expiration of the special rule for Puerto Rico's OZ designations.

The OZ Working Group includes qualified opportunity funds (QOFs), investors, syndicators, lenders, community development entities (CDEs), community development financial institutions (CDFIs), for-profit and nonprofit developers, consultants, law firms, and other community development professionals who work together to suggest consensus solutions to technical OZ incentive issues and provide recommendations to make the OZ incentive more efficient in delivering benefits to low-income communities.

Our comments reflect the work of a broad cross-section of OZ stakeholders participating in numerous conference calls and countless drafting sessions over several years. We trust you will find our comments useful and instructive. All of the OZ Working Group's previous comment letters can be found on our website (https://www.novoco.com/resource-centers/opportunity-zones-resource-center/opportunity-zones-working-group/published-comment-letters).

We appreciate the opportunity to submit our suggestions. With this additional guidance, we believe that the OZ incentive can be an even more effective tool in restoring economic growth throughout the country. We commend the Department of Treasury and IRS for their continuing efforts to improve and clarify tax guidance for the OZ incentive in order to ensure its continuing success. Thank you in advance for your time and consideration.

Please contact us if you have any questions regarding our comments or if we can be of further assistance. We would be happy to schedule a call to discuss our comments in further detail.

Yours very truly,

Novogradac and Company LLP

Jason Watkins

By

Jason Watkins, Partner

Cc: Ken Kies, Assistant Secretary of the Treasury

Derek Theurer, Acting Deputy Secretary and Assistant Secretary for Legislative Affairs

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Attachment:

Recommendations for Implementation OZ Guidance

Recommendations for Immediate OZ Guidance

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Recommendations for Implementation OZ Guidance

1. Determining Census Tract Eligibility

Regarding the determination of census tract eligibility, there are three areas where we are providing recommendations:

1. Census data used to determine eligibility
2. Concerns about the reliability of American Community Survey estimates of median family income
3. Eligibility of zero-population census tracts

Issue #1 – Census data used to determine eligibility

Under the One Big Beautiful Bill Act (OBBBA), new census tracts will be designated as OZs in 2026 and become effective January 1, 2027. The beginning of the 90-day determination period during which the states may nominate census tracts to be OZs is July 1, 2026. The legislation is silent as to what dataset will be used to determine which census tracts meet the definition of low-income communities that are eligible for nomination.

During the 2018 OZ determination period, the states were given the option of using either the 2011-2015 or the 2012-2016 American Community Survey (ACS) 5-year datasets to determine census tract eligibility. Both datasets were allowed even though the 2012-2016 dataset had been released on December 7, 2017, making it the most recent U.S. Census data available at the time of enactment of the OZ incentive as part of the Tax Cuts and Jobs Act.

In Revenue Procedure 2018-16, the Internal Revenue Service (IRS) noted the following regarding states' ability to use either dataset:

> *In the fall of 2017, the Census Bureau released the 2012-2016 ACS 5-Year data. Because of the March 21, 2018, deadline for State CEOs to nominate tracts for designation as QOZs, the maximum aggregate number of designations in a State is determined on the basis of the 2011-2015 ACS, as reflected in the Information Resource described above.*
>
> *In addition, the Information Resource is a "safe harbor." That is, if the Information Resource identifies a census tract as being either an eligible LIC or an eligible non-LIC contiguous tract, a State CEO's nomination of that tract will not fail to be certified on the grounds that the tract is no longer eligible under more recent census data.*
>
> *On the other hand, in many cases, if a tract is eligible under the most recent available ACS 5^{th}-Year data, the tract is eligible to be nominated for designation. If the Information Resource, however, does not identify the tract as eligible, the nomination must be accompanied by an analysis demonstrating that eligibility, including appropriate supporting data from that ACS.*

In 2018, states were allowed to use the 2011-2015 ACS data as a safe harbor to nominate census tracts, even if the census tracts would no longer have qualified under the more recent 2012-2016 ACS data. States were also allowed to use the 2012-2016 ACS data to qualify census tracts that did not qualify under the 2011-2015 ACS data. The ability to use either set gave the states additional flexibility to make the most of the limited number of nominations available.

Recommendation #1 - Census data used to determine eligibility

To allow states the flexibility to nominate census tracts that have the greatest community development potential, we recommend that Treasury and IRS issue guidance to the states similar to Revenue Procedure 2018-16 to specify that chief executive officers can nominate any individual tract that qualifies under either the 2019-2023 or 2020-2024 ACS 5-year data.

Issue #2 – Concerns about the reliability of American Community Survey estimates of median family income

<u>Reliability of Median Family Income Estimates</u>

The OBBBA modified the criteria for census tracts to be eligible for nomination as OZs. A census tract must be a "low-income community" which means any population census tract that has either:

- An MFI that does not exceed 70 percent of its geographic area's MFI; or
- A poverty rate of at least 20 percent, with an MFI that does not exceed 125 percent of its geographic area's MFI

The ACS median family income (MFI) data is a survey-based estimate and for some census tracts, the estimate is subject to a significant margin of error. A good example of this is Census Tract 13121005504 in Atlanta. Under the newly released 2020-2024 ACS 5-year data, its percentage of MFI is 71.56% and its poverty rate is 12.58%, so it doesn't meet the eligibility requirements. While its estimated MFI is $76,750, that's with a margin of error of $45,275, or 59% of the estimate. To get under the 70% threshold, this census tract's AMI would need to be less than $75,075, which is well within the margin of error.

Many census tracts will have survey-based MFI estimates that are slightly above either the 70% or 125% threshold, but in reality, may be eligible, if the actual MFI was known.

This issue isn't unique to selecting OZs. The Department of Housing and Urban Development (HUD) uses this MFI data to calculate income limits for various HUD programs. HUD addresses the reliability issue by categorizing ACS data as unreliable if a census tract 's MFI estimate has a margin of error of 50 percent or more of the estimate. In its report "Methodology for Calculating FY 2025 Medians", HUD provides:

> *"For the FY 2025 medians, HUD requires that the margin of error must be less than half of the estimate and that the survey median is based on at least 100 responses (as identified by a count indicator value of 4 or more in HUD's special tabulations of ACS data). If the current one-year or five-year estimate does not meet both conditions, HUD next examines the current and previous two five-year estimates. If at least two of these three estimates have margin of errors that are less than half their estimates, HUD takes the average of all such "minimally reliable" estimates (first inflating all values to the current ACS year5) and uses this as the median family income basis. If less than two of the estimates are minimally reliable, HUD uses the median family income estimate for the next largest geographic area which contains the area in question. For example, a single non-metropolitan county without a valid county-level median family income estimate will receive the estimate for the non-metropolitan portion of its state, while an HMFA will receive the estimate for its OMB-defined metropolitan area."*

Below are three additional census tracts from just the Atlanta Metropolitan Area whose MFI estimates HUD would deem to be unreliable due to large margins of error, and which would require further analysis to determine a reliable MFI estimate:

<u>Census tract 13121008907</u>

This census tract's MFI estimate using the 2020-2024 ACS 5-year data is 79.00% of AMFI and its poverty rate is 8.82%, which would make the census tract ineligible for OZ nomination. The tract's MFI estimate of $84,725 is subject to a margin of error of $52,609, or 62.09% of the estimate.

<u>Census tract 13121010532</u>

This census tract's MFI estimate using the 2020-2024 ACS 5-year data is 75.08% of AMFI and its poverty rate is 4.71%, which would make the census tract ineligible for OZ nomination. The tract's MFI estimate of $80,525 is subject to a margin of error of $51,255, or 63.65% of the estimate.

<u>Census tract 13121001701</u>

This census tract's MFI estimate using the 2020-2024 ACS 5-year data is 184% of AMFI and its poverty rate is 34.1%, so despite the very high poverty rate, the census tract would be ineligible for OZ nomination. The tract's MFI estimate of $198,080 is subject to a margin of error of $123,708, or 62.5% of the estimate.

<u>Missing Median Family Income Data</u>

Fulton County, Georgia contains a total of 327 census tracts. Of these, 30 census tracts (9.17%) have no MFI estimate listed in the 2020-2024 ACS 5-year data. For these census tracts, the MFI estimate is listed as "-", which per the Census Bureau, means the following:

The estimate could not be computed because there were an insufficient number of sample observations. For a 5-year median estimate, the margin of error associated with a median was larger than the median itself.

The Census Bureau considers the median family income data to be unreliable and so publishes nothing. An example is census tract 13121008203. In the 2020-2024 ACS 5-year data, it has a poverty rate of 19.39% but since it has no MFI listed, it will be ineligible for OZ nomination. However, the 2019-2023 ACS 5-year data showed its MFI estimate as 66.71% of AMFI.

Allowing reliance on a prior QOZ designation in circumstances of high data uncertainty appropriately addresses anti-abuse concerns. Where ACS estimates exhibit high margins of error, the statistical uncertainty makes it challenging to reliably determine whether current conditions have materially changed from the prior decennial determination round. In those cases, a prior QOZ designation and certification—made pursuant to statutory criteria and contemporaneous data—serves as a strong proxy for persistent distress and continued revitalization need. This approach ensures continuity of the original policy objective of encouraging long-term investment in historically underserved communities, while preventing potentially arbitrary exclusion of tracts based on statistically unreliable measurements rather than meaningful economic change.

Recommendation #2 – Reliability of American Community Survey estimates of median family income

We recommend that Treasury permit chief executive officers to use HUD's methodology or an alternative analysis subject to Treasury's approval to demonstrate eligibility for census tracts that meet one of the following criteria:

1. For census tracts geographically located wholly within one or more previously designated and certified QOZs from the immediately preceding decennial determination,
   a. An MFI subject to a margin of error of at least 35 percent of the MFI estimate where a qualifying MFI would fall within the margin of error; or
   b. Insufficient data to determine an MFI estimate
2. For census tracts geographically not wholly located within one or more previously designated and certified QOZs from the immediately preceding decennial determination,
   a. An MFI subject to a margin of error of at least 50 percent of the MFI estimate where a qualifying MFI would fall within the margin of error; or
   b. Insufficient data to determine an MFI estimate

Issue #3 – Eligibility of zero-population census tracts

As articulated in existing IRS guidance, the core objective of the OZ incentive is to "spur economic growth and job creation in low-income communities by providing tax benefits to investors." The current uncertainty surrounding the treatment of no-population tracts impedes governors' ability to strategically direct capital toward distressed but economically significant areas—particularly in post-industrial regions such as the Midwest and Appalachia, where deindustrialization, environmental degradation, and regional disinvestment have hollowed out entire communities.

We are specifically referring to census tracts with zero recorded population due to former industrial use or brownfield conditions, yet which remain integral to a broader economic redevelopment strategy. Examples include:

- Census Tract 39035980100 in Cleveland's Industrial Flats;
- Census Tracts 18127980001 and 18127980002 at Burns Harbor, Indiana—adjacent to Gary—home to critical steel manufacturing infrastructure;
- And large swaths of downtown Detroit encompassing depopulated neighborhoods and legacy manufacturing corridors.

In line with bipartisan legislative proposals introduced since 2022—such as S. 4065, the Rust to Revitalization Act—we encourage Treasury to adopt a "special rule" for this category of tract. This would allow for nomination eligibility where a census tract:

- Reports no population;
- Has documented industrial or brownfield history; and
- Is contiguous with a currently eligible Opportunity Zone and/or tract eligible under the One Big Beautiful Bill Act (OBBBA) of 2025.

Importantly, the inclusion of qualifying no-population tracts would represent a negligible expansion of the total eligible tract pool within any given state, while granting governors critical flexibility to nominate sites that are economically vital yet historically overlooked. Notably, industrial and operating business uses received the smallest share of Opportunity Zone investment under the original OZ framework, a shortfall Congress aimed to address—in part through enhanced rural tract benefits in the OBBBA of 2025. Allowing states to nominate zero-population tracts with clear industrial or redevelopment potential supports real job creation and long-term economic revitalization. Empowering state executives with this discretion helps align the OZ incentive with local redevelopment priorities and the on-the-ground realities unique to each state.

The sections that follow provide additional background, outline the national scope of affected tracts, and explore potential policy and administrative remedies.

Background

Under the current framework of the OZ incentive, census tract eligibility is determined using population-based economic indicators—specifically, whether a tract's median family income does not exceed 80% of the Area Median Income (AMI) or whether it has a poverty rate of at least 20%. In reauthorizing the incentive under the OBBBA of 2025, Congress tightened the AMI threshold to not to exceed 70%. Arguably, census tracts with no recorded population have 0% AMI and, under a literal reading, have an AMI that does not exceed 70%.

These zero-population tracts—many of which include industrial corridors, brownfield sites, or other historically active economic zones—have been functionally excluded from consideration despite their economic importance.

This exclusion presents an oversight of the administration of the incentive. Many zero-population tracts are adjacent to low-income neighborhoods and represent the highest-need areas for redevelopment, particularly in regions shaped by deindustrialization and disinvestment. In places like Cuyahoga County, Ohio (Cleveland) and Wayne County, Michigan (Detroit)—two urban cores with persistent poverty and high vacancy rates—there are a combined 49 zero-population tracts that include heavy manufacturing zones, abandoned railyards, and major brownfield assets with high potential for reuse.

Allowing governors the discretion to nominate such tracts would align the OZ designation process more closely with ground-level redevelopment strategy, especially in legacy industrial states.

Scope: Additional zero-population tract calculations

Based on current eligibility criteria, approximately 25,336 census tracts across the United States meet the federal thresholds for OZ designation. Additionally, there are roughly 1,040 census tracts nationwide with no recorded population data. These zero-population tracts typically include large parcels of land classified for:

- Industrial or former industrial use (brownfields)
- Transportation infrastructure (rail yards, ports, and airports)
- Government holdings such as Army, Navy, and Air Force bases
- State and national parks
- Unimproved or protected land

Crucially, this request is limited to a further subset of zero-population tracts that are of industrial, commercial, or redevelopment significance—and not those associated with military installations, recreational land, or preserved wilderness. This significantly reduces the number of potentially eligible zero-population census tracts.

While preliminary modeling suggests that up to 260 additional tracts could be added as eligible nationwide if all zero-population tracts were made eligible, that figure includes areas not relevant to the intent of this request. By focusing the recommendation to only include tracts with current or former industrial use, the actual number of potentially impacted tracts would be further lowered.

Recommendation #3 – Eligibility of zero-population census tracts To ensure the OZ incentive fulfills its goal of driving investment into distressed and underutilized areas, we recommend that the U.S. Department of Treasury adopt the following interpretive or regulatory approaches for census tracts with no recorded population:

1. Literal Interpretation of Statutory Thresholds

Under Internal Revenue Code (IRC) Section 1400Z-1(c)(1), census tracts qualify as Low-Income Communities (LICs) if their median family income (MFI) is not more than 70% of the surrounding area median. The Census Bureau typically reports MFI as zero in tracts with no population due to the absence of households. A straightforward reading of the statute implies that a zero MFI inherently falls below the threshold, qualifying the tract as a LIC, notwithstanding the absence of population data.

2. Codify Legislative Intent through Regulatory Flexibility

Congress has demonstrated bipartisan interest in this issue through at least five proposed bills. Most notably, the Rust to Revitalization Act of 2022 (H.R. 7183) sought to establish a "special rule" for tracts meeting the following criteria:

- Zero recorded population
- Former industrial or brownfield land use
- Contiguity to a designated OZ

Treasury should consider using its existing regulatory authority to implement a comparable approach, reflecting Congress's intent and empowering state executives to nominate high-potential redevelopment tracts that otherwise fall outside the default eligibility criteria.

By adopting one or more of these approaches, Treasury can ensure that strategically located no-population tracts with significant redevelopment potential—particularly in industrial regions—are not arbitrarily excluded from participation in OZ 2.0.

2. QOF and QOZB Reporting Requirements

Regarding QOF and QOZB reporting requirements, we have identified six areas where we provide recommendations:

- Data collection and timely reporting
- Penalty assessments for failure to comply with information reporting requirements
- Additional penalty assessments for intentional disregard
- Qualified opportunity zone business reporting
- Residential units data
- Jobs created data

Issue #1 – Data collection and timely reporting

The OBBBA created additional reporting requirements for qualified opportunity funds (QOFs) effective for tax years beginning after the date of enactment (July 4, 2025). New IRC Section 6039K requires the following additional data points:

- Name & address of any qualified opportunity zone business (QOZB) in which the QOF has invested

- North American Industry Classification System (NAICS) code that applies to the trades or businesses of either the QOF or the QOZB(s) in which it has invested
- The approximate number of residential units (if any) of the property held by either the QOF or the QOZB(s) in which it has invested
- The approximate number of full-time equivalent employees of the QOF or any QOZBs in which the QOF has invested (or such other indication of the employment impact of such trades or businesses as determined appropriate by the Secretary)
- With respect to each person who disposed of an investment in a QOF during the tax year
    - The name, address, and taxpayer identification number of such person
    - The date or dates on which the investment disposed was acquired
    - The date or dates on which the investment was disposed and the amount of the investment disposed
- Such other information as the Secretary may require

QOFs are also now required to furnish a statement to investors showing:

- The name, address, and phone number of the information contact of the person required to make such return
- Additional information to investors who disposed of an investment in a QOF

The purpose of the additional data collection is so legislators can receive timely reporting on the volume, utilization, and geographic distribution of OZ investment. Data collected on an expanded Form 8996 will be subject to taxpayer privacy issues which will impact both the timing and the detail available on reporting. Reporting based on tax returns on the OZ incentive released to date has generally been delayed at least 2 years and is lacking in specificity. For instance, the Office of Tax Analysis's working paper "Use of the Opportunity Zone Tax Incentive: What the Data Tell Us" that analyzed OZ data from the 2018-2020 Forms 8996 was not released until 2023. The report itself generally presents high-level data with no data presented at the census tract level, making it difficult to assess the impact of the OZ incentive.

Recommendation #1 – Data collection and timely reporting

To provide more timely and detailed data reporting, we recommend that a data collection system other than an expanded Form 8996 be used by IRS and Treasury to collect data from QOFs. One such option would be to adapt the CDFI Fund's Awards Management Information System (AMIS) for use with OZ reporting. AMIS is already used to collect numerous data points for the New Markets Tax Credit incentive that are used to prepare statutorily required reporting to Congress.

Issue #2 –Penalty assessments for failure to comply with information reporting requirements

QOFs that fail to comply with the information reporting requirements are subject to penalties under new IRC Section 6726. Penalties are assessed at $500/day for QOFs with assets up to $10 million and $2,500/day for QOFs with assets greater than $10 million. Maximum penalties (assuming no intentional disregard – see Issue #3 below) may range from $10,000 to $50,000. The vast majority of QOFs hold investments into QOZBs, from whom most of the information the QOFs need to meet their reporting requirements under IRC Section 6039K will need to be gathered. If a QOF is unable to collect the necessary information from one or more QOZBs in which it is invested, it should be able to claim a reasonable cause exception to request relief from the automatic penalty assessment.

Recommendation #2 – Penalty assessments for failure to company with information reporting requirements

We recommend that Treasury and IRS issue guidance or tax form instructions that allow for a QOF to claim relief under a reasonable cause exception if it is unable to collect from a QOZB the information necessary to meet the reporting requirements of IRC Section 6039K.

Issue #3 – Additional penalty assessments for intentional disregard

In the cases of an intentional disregard by a QOF that fails to file a complete and correct return in the time and in the manner prescribed, both the daily and maximum penalties are multiplied by five. However, what constitutes an "intentional disregard" is not addressed in IRC Section 6726.

Recommendation #3 – Additional penalty assessments for intentional disregard

We recommend that Treasury and IRS issue regulations or sub-regulatory guidance that defines an intentional disregard and provides examples of where a QOF would be deemed to have had an intentional disregard in meeting the reporting requirements.

Issue #4 – Qualified opportunity zone business reporting

The OBBBA created reporting requirements for QOZBs effective for tax years beginning after the date of enactment. Under newly created IRC Section 6039L, QOZBs are now newly required to provide a written statement to their QOF investors that includes the information the QOFs need to complete the reporting requirements in IRC Section 6039K.

While the majority of QOZBs are formed as partnerships that provide K-1s to their partners, many QOZBs are formed as corporations that do not provide passthrough information to their owners. For that reason, QOZB-level reporting should not be a part of the QOZB's tax return and should instead be reported using another means. Additionally, regardless of the ultimate form that the QOF information reporting takes, QOFs will need have sufficient time to receive and process the data received from QOZBs in order to meet its filing deadline.

Recommendation #4 – Qualified opportunity zone business reporting

We recommend that Treasury and IRS create a standard worksheet that QOZBs will be required to use to report information to their QOF investors. If an expanded Form 8996 is ultimately selected to be the reporting method, we further recommend that the deadline for a QOZB to provide this information to a QOF be no later than 15 days prior to the due date of the QOF's tax return, without extension. The QOF would be responsible for notifying the QOZB of the due date and providing the worksheet to the QOZB.

Issue #5 – Residential units data

QOFs are now required to report the approximate number of residential units (if any) held by the QOF or by any QOZB in which the QOF has invested under new IRC Section 6039K(b)(5)(G). To maximize the information gained from QOFs, Treasury should specify that residential units data include both sales and rental data and the numbers reported should be cumulative. For residential units sold, this number would include the number of single-family homes sold directly to homeowners. Rental residential units should include build-for-rent single-family homes and be broken down into numbers of affordable units (less than 80% AMI), workforce housing units (80%-120% AFI), and market-rate units (> 120% AMI).

Recommendation #5 – Residential units data

We recommend that Treasury issue regulations to expand the types of residential units data collected to include single-family homes sold directly to homeowners and to separately collect data on the number of residential rental units that qualify as affordable, workforce housing, and market rate.

Issue #6 – Jobs created data

QOFs are now also required to report the approximate average monthly number of full-time equivalent employees of the QOF or of any QOZB in which the QOF has invested for the year (within numerical ranges identified by the Secretary) or such other indication of the employment impact of such corporation or partnership as determined appropriate by the Secretary under new IRC Section 6039K(b)(5)(G). Without additional guidance, QOFs and QOZBs will likely not consistently report jobs created data. For instance, stakeholders have inquired whether construction jobs, direct jobs, indirect jobs, and tenant jobs should all be included and should the data reported be cumulative or for the current year only.

Recommendation #6 – Jobs created data

We recommend that Treasury issue regulations to ensure consistency in the jobs created data provided by QOFs, Treasury should specify that the following data jobs created information be collected and that the number of jobs created be cumulative:

- Full-time equivalent jobs created (construction)
- Full-time equivalent jobs created/retained at QOF/QOZB (permanent)
- Full-time equivalent jobs created/retained at tenant businesses (permanent)

3. Deferral of Gains from 2026 Inclusion Events

Issue – Deferral of Gains from Inclusion Events

Treasury Regulation 1.1400Z2(a)-1(b)(11)(iv) makes it clear that taxpayers may elect to re-defer gains arising from inclusion events because the taxpayer treats the inclusion date as if it was originally realized upon the occurrence of the inclusion event rather than on the date of the sale or exchange that gave rise to the gain that was originally deferred. Some OZ investors will have inclusion events during 2026 where the 180-day period for deferral through investment into a qualified opportunity fund will not expire until on or after January 1, 2027. Based on the existing regulations, these 2027 investments should be eligible for a five-year gain deferral as well as a 10 percent or 30 percent basis step-up after five years. However, investors may be hesitant to invest these gains without clarifying guidance that gains from inclusion events are eligible for OZ 2.0 benefits.

Recommendation – Deferral of Gains from Inclusion Events

We request that Treasury reaffirm that gains from inclusion events in 2026 are eligible for deferral through investment into a qualified opportunity fund in 2027 provided the 180-day investment period has not lapsed.

Contents

Recommendations for Immediate OZ Guidance

1. Expiration of OZ Designations

Regarding the expiration of existing OZ designations, we have identified three areas where guidance is desired:

- Dual OZ designations for 2027/2028,
- Legacy business eligibility, and
- Compliance with QOF/QOZB tests.

Issue #1 - Dual OZ Designations for 2027/2028

Under the One Big Beautiful Bill Act (OBBBA), existing OZ designations continue through December 31, 2028 and new census tracts will be designated in 2026 as OZs effective January 1, 2027. This will result in a two-year period with two sets of OZ designations in place. IRC 1400Z-1(d)(1) states "*Except as provided by paragraph (2), the number of population census tracts in a State that may be designated as qualified opportunity zones under this section during any period may not exceed 25 percent of the number of low-income communities in the State."* We believe "any period" references the period for which designations are made, and, as such, limits only the designations made in the nomination round. We note that this will only be an issue during the 2027/2028 transition period because there will be no overlapping periods with future designations.

Recommendation #1 - Dual OZ Designations for 2027/2028

To avoid potential misinterpretation, we recommend that Treasury issue guidance to define "period" as each period beginning on an applicable start date and ending on the day before the date that is 10 years after the applicable start date and that for 2027/2028, there will be two overlapping periods in effect.

Issue #2 - Legacy Project Eligibility

Current OZ designations are set to expire on December 31, 2028. The current statute and final regulations give rise to uncertainty regarding what property will be eligible for treatment as qualified OZ business property (QOZBP) when the property is in an OZ whose designation expires.

Under Internal Revenue Code (IRC) Section 1400Z-2(d)(2)(D), QOZBP is defined as follows:

- For property acquired before January 1, 2027, such property was acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after December 31, 2017.

- For property acquired after December 31, 2026, such property was acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after the applicable start date (as defined in section 1400Z-1(e)(2)) with respect to the qualified opportunity zone described in subclause (III)

The above criteria also apply to property owned by a QOZB. In both cases, the property must also meet two additional criteria:

- The original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund substantially improves the property, and

- During substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

The final OZ regulations contain a safe harbor where the acquisition date for self-constructed property is the date on which manufacture, construction, or production begins. Under the final regulations, physical work of a significant nature will not be considered to begin before the taxpayer incurs or pays more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching). As the expiration of existing OZs approaches, there is heightened concern among OZ stakeholders that the 10% threshold and the exclusion of land and predevelopment costs is an unreasonably high bar. Investors are at risk of investing in developments in an existing OZ that could ultimately fail to satisfy the 10% safe harbor due to prolonged, costly and unexpected delays beyond their control.

Below is a non-exhaustive list of seven scenarios that demonstrate this uncertainty. Without guidance, such uncertainty will greatly dampen the amount of investment in existing OZs well before the expiration of their OZ designations.

<u>Scenario #1 – QOZB Under Contract to Acquire Property Before Loss of OZ Designation</u>

On August 1, 2028, a QOF invests $10 million into a business that intends to be a QOZB. The business has a valid working capital safe harbor written plan and schedule to identify and acquire land and then construct a property over a 31-month period in a currently designated OZ that is not redesignated as an OZ in 2026. Prior to December 31, 2028, the business is under contract to acquire the land and has incurred $250,000 of predevelopment costs related to the property it intends to construct. Under the existing safe harbor, this property would not be treated as acquired until after the expiration of the census tract's OZ designation.

<u>Scenario #2 – Construction Delays</u>

On August 1, 2026, a QOF plans to invest $10 million into a business that intends to be a QOZB. The business has a valid working capital safe harbor written plan and schedule to acquire land and construct a property over a 30-month period in a currently designated OZ that is not redesignated as an OZ in 2026. The business intends to acquire the land on October 1, 2026 and immediately begin physical work on the property. The business does acquire the land on October 1, 2026 but due to a force majeure event, the business is unable to begin physical work on the property until October 1, 2028 and does not incur or pay more than 10 percent of the total cost of the property, excluding land and building costs, until February 28, 2029. This property would not qualify under the existing safe harbor as being treated as acquired before the expiration of the census tract's OZ designation.

<u>Scenario #3 – Governmental Permitting Delays</u>

On August 1, 2027, a QOF plans to invest $10 million into a business that intends to be a QOZB. The business has a valid working capital safe harbor written plan and schedule to acquire land and construct a property over a 30-month period in a currently designated OZ that is not redesignated as an OZ in 2026. The business acquires the land on June 1, 2028 but is unable to immediately begin physical work on the property due to six months of governmental permitting delays. Physical work begins on the property on December 1, 2028 but less than 10 percent of the total cost of the property, excluding land and predevelopment costs, is incurred by December 31, 2028. Under the existing safe harbor, this property would not be treated as acquired until after the expiration of the census tract's OZ designation.

<u>Scenario #4 –Projects with Extended Development Times</u>

On August 1, 2026, a QOF invests $10 million into a business that intends to be a QOZB, with a second $10 million investment planned for February 1, 2029. The business has a valid working capital safe harbor written plan and schedule to immediately acquire land and construct a property over a 60-month period in a currently designated OZ that is not redesignated as an OZ in 2026. Construction is completed on time and the property is placed into service on July 31, 2031. There is a lack of guidance as to whether investors can make qualifying additional investments into a QOF that uses those investments to make additional investments into a QOZB after the expiration of the census tract's OZ designation. Without relief, uncertainty as to whether the post-2028 investment qualifies will deter many investors from investing in such a business.

<u>Scenario #5 – Cost Overruns</u>

On August 1, 2028, a QOF invests $10 million into a business that intends to be a QOZB. The business has a valid working capital safe harbor written plan and schedule to immediately acquire land and construct a property over a 30-month period in a currently designated OZ that is not redesignated as an OZ in 2026. Physical work begins immediately and more than 10% of the total cost of the property, excluding land and predevelopment costs, is incurred by December 31, 2028. Due to unforeseeable economic conditions, the cost of certain construction materials has increased significantly, resulting in additional capital needs. Investors invest an additional $2.5 million into the QOF which invests the $2.5 million into the business on August 1, 2030. There is a lack of guidance as to whether investors can make qualifying additional investments into a QOF that uses those investments to make additional investments into a business after the loss of the census tract's OZ designation. Without relief, uncertainty over whether the post-2028 investment qualifies will deter many investors from investing in such a business.

<u>Scenario #6 – Substantial Capital Improvements</u>

A QOZB places a property into service prior to December 31, 2028 in a currently designated OZ that is not redesignated as an OZ in 2026. After December 31, 2028, the property requires substantial capital improvements, including a new roof, and the improvements are placed into service after the expiration of the census tract's OZ designation. The capital improvements total more than 30 percent of the total tangible property owned by QOZB. If these capital improvements do not qualify the QOZB will not meet the 70 percent qualified tangible property standard. Under the existing safe harbor, the improvements would not be treated as acquired until after the expiration of the census tract's OZ designation. Without relief, necessary capital improvements incurred after the expiration of an OZ could cause a business to cease being a QOZB, the loss of OZ tax benefits to investors in the QOF and significant investor penalties.

<u>Scenario #7 – QOZB Acquires Replacement Property after Loss of OZ Designation</u>

On August 1, 2028, a QOF invests $10 million into a business that intends to be a QOZB. The business has a valid working capital safe harbor written plan and schedule to identify and acquire land and then construct a property over a 30-month period in a currently designated OZ that is not redesignated as an OZ in 2026. After the business receives the QOF investment, the planned land acquisition fails to close, and the business is unable to identify a replacement property in the same census tract until after December 31, 2028. In early 2029, the business identifies a property in the same census tract whose OZ designation has now expired, and acquires the land on February 1, 2029, then completes construction and places the property into service on February 28, 2031. Under the existing safe harbor, this property would not be treated as acquired until after the expiration of the census tract's OZ designation. Without additional relief, uncertainty regarding the consequences of failing to acquire the planned assets will deter many investors from investing in such a business.

Recommendation #2 - Legacy Project Eligibility

To provide investors with confidence that investments into OZs that are approaching the end of their designation period will still be able to qualify, we recommend Treasury issue clarifying regulations similar to the language regarding the treatment of preexisting investments in decertified OZs from H.R. 5761 (118th Congress) - Opportunity Zones Transparency Extension and Improvement Act. We recommend the following new paragraph (vi) to section 1.1400Z2(d)-2(b)(4):

(vi) Rules for qualified preexisting investments

(A) In general. Any property self-constructed by a qualified preexisting trade or business is considered acquired by December 31, 2028.

(B) Qualified preexisting trade or business. For purposes of this paragraph—

(1) In general. The term 'qualified preexisting trade or business' means any trade or business of a qualified opportunity zone fund or qualified opportunity zone business which meets the requirements of clauses (ii) and (iii) of section 1400Z–2(d)(3)(A) and with respect to which—

(i) before the end of a census tract's opportunity zone designation period, filed a registration statement under the Securities Act of 1933 (15 U.S.C. 77a et seq.) or prepared any comparable offering memorandum or similar disclosure document provided in reliance on section 230.506 of title 17, Code of 1 Federal Regulations (or successor regulations), promulgated under the Securities Act of 1933, or prepared an organizational document or working capital safe harbor written plan and written schedule that discloses the intent of such trade or business to invest in the census tract,

(ii) before the end of a census tract's opportunity zone designation period, has made, or has entered into binding agreements to make, investments in the census tract which aggregate the lesser of $250,000 or 5 percent of reasonably expected development costs, and have been designated in writing for the use in, or the development of, such trade or business, or

(iii) the qualified opportunity fund or qualified opportunity zone business is determined by the Secretary to have relied on the designation of the census tract as a qualified opportunity zone and to have suffered a loss as a result of the census tract's opportunity zone designation expiring.

(C) Trade or business. The term 'trade or business' includes any activity intended to qualify as a trade or business within the meaning of section 162.

(D) Additional investments from qualified opportunity funds. All investments from a qualified opportunity fund into a qualified opportunity zone business with a qualified preexisting trade or business will be treated as qualified opportunity zone property in the hands of the qualified opportunity fund.

Issue #3 - Compliance with QOF/QOZB Tests After Expiration of OZ Designation

Under IRC 1400Z-2(d), a QOF is required to hold at least 90 percent of its assets in qualified OZ property, of which an investment into a QOZB qualifies. The typical structure of an OZ investment involves a QOF investing into a QOZB. Treasury guidance is requested to ensure that a QOZB can maintain its qualification as a QOZB after the census tract in which it operates loses its OZ designation.

Under IRC 1400Z-2(d)(3), QOZBs are required to meet several tests on a recurring basis for what is typically a minimum 10-year period. Several of these compliance tests are dependent upon the census tract in which the trade or business operates being an OZ.

- 70-percent tangible property test: the IRC and the regulations promulgated thereunder require that *during substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone*. The first instance of "substantially all" is defined in the final Treasury Regulations as 90 percent and the second instance is defined as 70 percent. If the census tract in which the QOZB operates is no longer an OZ for compliance testing purposes, then it will not be possible for the QOZB to meet this requirement.

- 50-percent gross income test: the IRC and the Treasury Regulations promulgated thereunder require that at least 50 percent of the total gross income of the QOZB be derived from the active conduct of such business in the OZ. Again, if the census tract in which the QOZB operates is no longer an OZ for compliance testing purposes, then it will not be possible for the QOZB to meet this requirement.

- 40-percent intangible property test: the IRC and the Treasury Regulations promulgated thereunder require that at least 40 percent of the intangible property of the QOZB be used in the active conduct of such business in the OZ. Once more, if the census tract in which the QOZB operates is no longer an OZ for compliance testing purposes, then it will not be possible for the QOZB to meet this requirement.

Failure to meet any of the above tests would cause a business to no longer qualify as a QOZB, causing a QOF's investment into the business to likewise no longer qualify. With current OZs designations scheduled to expire on December 31, 2028, guidance that permits these entities to continue to qualify despite the loss of OZ designations is urgently needed.

Recommendation #3 - Compliance with QOF/QOZB Tests After Expiration of OZ Designation

In order to clarify that all existing QOFs and QOZBs can continue to qualify, we recommend adding the following new paragraph (xi) to section 1.1400Z2(d)-1(d)(3):

(xi) For the purposes of this paragraph, a qualified opportunity fund or qualified opportunity zone business may continue to treat as a qualified opportunity zone, for compliance testing purposes only, any census tract in which it operates or is developing property that was a qualified opportunity zone at the time of the qualified opportunity fund's or qualified opportunity zone business's initial investment into the qualified opportunity zone.

2. Clarification on Notice 2025-50 Related to Rural Investments

Issue – Properties Eligible for Lower 50% Substantial Improvement Incentive

The OBBBA created additional incentives for investments made into rural areas. A higher 30-percent basis step up is available for investments made after December 31, 2026 into qualified rural opportunity funds. A lower 50% substantial improvement rule for properties located in rural areas was effective upon enactment. As a result, immediate guidance as to what constitutes a rural area was critical so that investors could use this lower threshold.

IRS Notice 2025-50 (the "Notice"), issued on September 30, 2025, identifies the currently designated opportunity zone census tracts that qualify as rural for the purposes of the lower substantial improvement threshold. We greatly appreciate the speed with which this guidance was provided.

Section 3 of the Notice states that "this notice applies to all tangible property located in a 2018 QOZ that is comprised entirely of a rural area (as defined in section 4 of this notice) that has been, or is in the process of being, substantially improved (as described in section 5 of this notice)." The use of "that has been" indicates that the lower substantial improvement rule potentially applies to all property that has been acquired and improved in a 2018 QOZ from 2018 to now.

Section 5 of the Notice states "for any determination made on or after July 4, 2025, as to whether any tangible property located in a 2018 QOZ comprised entirely of a rural area meets the substantial improvement test described in § 1400Z 2(d)(2)(D)(ii), the substantial improvement test is satisfied if the additions to basis with respect to such property in the hands of the QOF or a qualified opportunity zone business exceed an amount equal to 50 percent of the adjusted basis of such property at the beginning of the 30-month period described in § 1400Z-2(d)(2)(D)(ii)." Taken in conjunction with the language in Section 3, the lower 50 percent substantial improvement threshold is applicable to properties for which no determination had been made prior to July 4, 2025. The following examples demonstrate potential applications of IRS notice 2025-50 and where additional guidance is recommended.

<u>Example 1 - Substantial Improvement in Process</u>

On January 1, 2024, a QOZB acquires a building for $1 million that had previously been placed in service by another unrelated taxpayer. The QOZB originally intended to invest $1.5 million to substantially improve the building over a 30-month period. Effective July 4, 2025, the building is in a rural OZ and as of that date, the QOZB has incurred improvements totaling $501,000. Is the building considered substantially improved?

<u>Example 2 – Retroactive Substantial Improvement</u>

On January 1, 2021, a business acquires for $1 million a building that had previously been placed in service by another taxpayer. The business incurred improvements totaling $501,000 in the 30-month period beginning on January 1, 2021. No determination regarding the building's substantial improvement has been made prior to July 4, 2025. Effective July 4, 2025, the building is in a rural

OZ. Is the building considered substantially approved on July 4, 2025, which may enable the business to be qualified as a QOZB as of that date, subject to other requirements?

<u>Example 3 – Previous Determination Made</u>

On January 1, 2023, a QOZB acquires a building for $1 million that had previously been placed in service by another taxpayer. By June 30, 2024, the QOZB believes it incurred improvements totaling $1,100,000 over 16 months, which is less than the allowable 30-month period. In an audit of the QOZB's 2024 tax return, the IRS determines that the building had not been substantially improved under the 100% threshold resulting in the QOZB not meeting the 70 percent qualified tangible property standard. Effective July 4, 2025, the building is in a rural OZ. Is the building considered substantially improved on July 4, 2025?

Recommendation - Properties Eligible for Lower 50% Substantial Improvement Incentive

To avoid potential misinterpretation, we recommend that Treasury issue guidance to clarify that any property located in a rural OZ will be considered substantially improved effective July 4, 2025 if additions to basis during any 30-month period after the property's acquisition exceed 50 percent of the property's adjusted basis.

3. Expiration of Special Rule for Puerto Rico

Issue – December 31, 2026 Expiration of Special Rule for Puerto Rico

The Bipartisan Budget Act of 2018 included a special rule that designated all of Puerto Rico's low-income communities as OZs. The OBBBA repealed this rule effective December 31, 2026. We believe that the intention of this repeal is that for all future rounds of OZ designations, Puerto Rico will be limited to the same rule that allows states to designate a maximum of 25% of low-income communities as OZs. However, a second possible interpretation of this repeal is that effective December 31, 2026, all of Puerto Rico's currently designated OZs would have their eligibility removed. Since Puerto Rico did not go through a formal nomination and designation process, this interpretation could result all of Puerto Rico's OZs losing their eligibility two years earlier than the rest of the OZs in the United States and its territories.

Recommendation – December 31, 2026 Expiration of Special Rule for Puerto Rico

We recommend that Treasury issue guidance as soon as practicable to clarify that the repeal of the special rule for Puerto Rico does not impact current designations, which will continue until December 31, 2028, and instead, the repeal applies only to future designation periods.