

34th Annual
Tax Symposium

THE WIZARD OF (Q)OZ:

***RURAL RICHES AND URBAN UPSIDES IN
QUALIFIED OPPORTUNITY ZONES (QOZS)***

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WHAT IS A “QOZ”?

A Qualified Opportunity Zone (QOZ) is an economically distressed community in the U.S. where new investments may be eligible for preferential tax treatment.

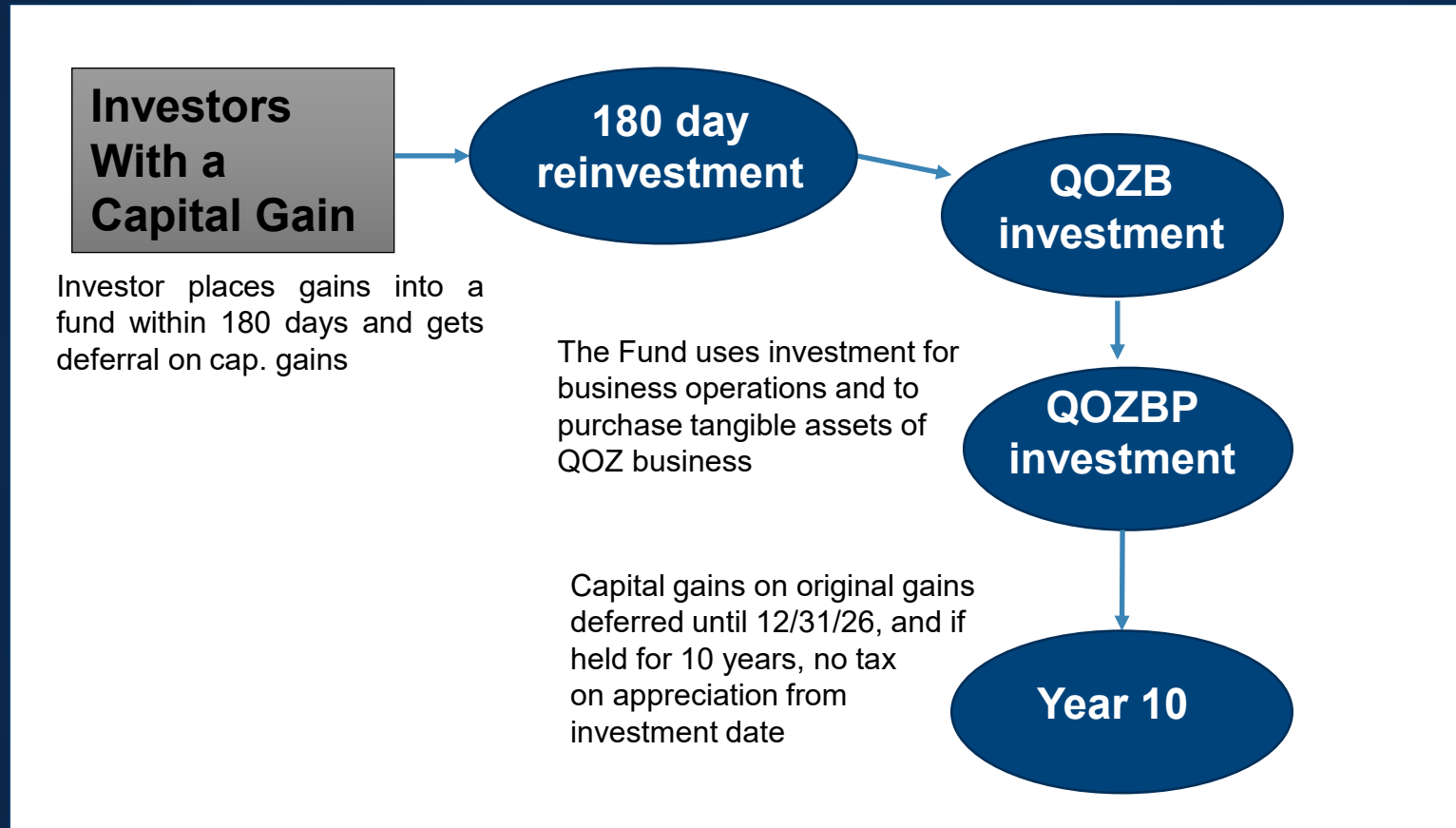
States nominate certain low-income census tracts to become QOZs. The U.S. Treasury Department then certifies the nominations.



CREATED BY TCJA IN 2017 AND EXPIRES DECEMBER 31, 2026

1. Deferral - Deferral of the gain until December 31, 2026 (or earlier if the taxpayer disposes of the investment)
2. Basis Step Up - A tax basis step up of 10% or 15% of the eligible gain amount if the contribution to a QOF was made prior to 2020 or 2022, respectively (which translates to a permanent exclusion of those amounts from taxable income), and
3. 10-Year Gain Exclusion - Exclusion of any gain recognized on the new OZ investment if the interest in the QOF has been held for at least ten years.

QOZ DEVELOPMENT WATERFALL



COMPLIANCE REQUIREMENTS

1. **Gross Income Requirement:** At least 50% of QOZ gross income from the active conduct of its trade or business in an OZ. There are four ways that a business can satisfy this requirement:
 - a) “Hours”
 - b) “Compensation”
 - c) “Property and Management”
 - d) “Facts and Circumstances”

COMPLIANCE REQUIREMENTS

2. Tangible Property Requirement

70% of the tangible property owned or leased by the QOZB must be Qualified Opportunity Zone Business Property (QOZBP). To qualify as QOZBP, tangible assets have to:

- Either be assets that are newly placed in service by the QOZB or ***substantially improved*** (defined as *doubling the basis*); and
- During the QOZB's holding period, substantially all of the use of the property has to be in an opportunity zone.

COMPLIANCE REQUIREMENTS

3. Intangible Property Requirement. at least 40% of the intangible property must be used in the active conduct of its trade or business in an OZ (if any).
4. 5% Financial Property Test. Less than 5% of the average aggregate unadjusted bases of the QOZBP can be attributable to nonqualified financial property (debt, stock, partnership interests, options, futures, forwards, warrants, etc.).
5. QOZB cannot be a “Sin” Business (Gambling, Tobacco, Marijuana, golf courses and country clubs)

DOES IT WORK?

Concentration of Benefits: 78% of all OZ investment flowed into just 5% of designated zones, while 63% of zones received zero investment.

Little effect on QOZ residents: Several studies have found little to no statistically significant effects on the employment, earnings, or poverty rates of QOZ residents.

But...

Increased Development: Some analyses show that QOZ designation led to a large and immediate increase in commercial and residential development activity in designated tracts. One study found that the likelihood of investment in a given month jumped by over 20% in some cities

NEW AND IMPROVED QOZ 2.0 PROGRAM

1. Duration—Permanent
2. Basis step-up—7-year bonus eliminated.
3. Exclusion—Rolling, with original gain fully excluded after 10 years
4. Creation of Rural Funds—specially designated rural QOZs have more relaxed rules and an extra 20% step-up (to 30%)

NEW AND IMPROVED QOZ 2.0 PROGRAM

New Compliance and Reporting Requirements (And Penalties For Non-Compliance)

QOFs must submit detailed annual reports covering:

- Total asset value.
- Details on QOZ property, including whether owned or leased, and the value of tangible and intangible property.
- The number of residential units owned.
- The number of full-time equivalent (FTE) employees.
- North American Industry Classification System (NAICS) codes for QOZ businesses and the census tracts they are located in.
- Information about investments in QOZ business subsidiaries.

NEW AND IMPROVED QOZ 2.0 PROGRAM

New Compliance and Reporting Requirements (And Penalties For Non-Compliance)

Active Business Conduct: QOFs (or their QOZ Businesses) must demonstrate the active conduct of a trade or business

Active Business Timeframe: QOZ Businesses typically have 31 months to deploy capital to satisfy active business requirements (though some extensions and safe harbors may apply)

NEW AND IMPROVED QOZ 2.0 PROGRAM

New Compliance and Reporting Requirements (And Penalties For Non-Compliance)

Monetary Penalties: Penalties of up to \$10,000 for small QOFs and up to \$50,000 for large QOFs (with gross assets over \$10 million) are imposed for failure to comply.

Willful Non-Compliance: Harsher penalties, including higher fines, apply for willful non-compliance.

'QOZ 2.0': SUMMARY OF CHANGES

	QOZ 1.0	QOZ 2.0
Duration	Expires 12/31/2026	Starts 1/1/2027; permanent on a 10-year rolling basis
Gain Deferral	Gain deferred to 12/31/2026	5-year rolling deferral
Basis step-up	10% (5 years) Additional 5% (7 years)	10% after 5 years.
Exclusion Cap	Permanent after 10 years	Same
Rural Funds (QROFs)	n/a	Step-up in basis increased to 30%
Compliance Reporting	Modest self-reporting	Expanded and significant penalties

‘QOZ 2.0’: FURTHER GUIDANCE NEEDED

- **New designation procedures:** A decennial redesignation process begins in 2026. The IRS needs to issue guidance on the new nomination and certification procedures for state governors (and not legislatures) and the Treasury Secretary—State Congresspeople may sue.
- **Treatment of investments in redesignated zones:** A key unresolved issue is how investments made into QOZs under the old criteria will be handled if their census tract no longer qualifies for QOZ status under the new rules. The transition needs to be explained by the Treasury.

‘QOZ 2.0’: FURTHER GUIDANCE NEEDED

- **Revised reporting requirements and penalties:** The OBBBA introduced stricter reporting requirements for Qualified Opportunity Funds (QOFs) and new penalties for noncompliance. The IRS must provide detailed instructions and forms for these new rules.
- **Clarification for “QOZ Judgment Day”:** Under the original program, deferred capital gains are recognized on December 31, 2026. This is a critical date for investors, and the IRS must confirm the process for calculating and reporting this gain, or if it will have a process for rolling over into new QOZ-2.0 investment. (**SEE NEXT SLIDE**)

'QOZ 2.0': FURTHER GUIDANCE NEEDED



The Government Shutdown and other Shenanigans in Washington D.C. means the IRS guidance will very likely be delayed until mid-late 2026 (at the earliest) and final regulations not issued until 2027

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THANK YOU



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