

## Part III - Administrative, Procedural, and Miscellaneous

### Transitional Guidance on Qualified Opportunity Zones under §§ 1400Z-1 and 1400Z-2

Notice 2026-40

#### SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue proposed regulations regarding qualified opportunity zones (QOZs) under §§ 1400Z-1 and 1400Z-2 of the Internal Revenue Code (Code)<sup>1</sup>, as amended by § 70421 of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), including transitional guidance related to qualifying investments under §§ 1400Z-1 and 1400Z-2, as in effect prior to amendment by § 70421 of the OBBBA (forthcoming proposed regulations). The forthcoming proposed regulations are anticipated to include proposed rules similar to the rules provided in sections 3 through 5 of this notice.

#### SECTION 2. BACKGROUND

##### .01 Sections 1400Z-1 and 1400Z-2

(1) Section 1400Z-1. Section 1400Z-1 provides the procedural rules for the designation of QOZs, the related definitions, and the applicable period for which such

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<sup>1</sup>Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

designations remain in effect.

(2) Section 1400Z-2. Section 1400Z-2 allows the deferral of inclusion in gross income for certain realized gains to the extent that corresponding amounts are timely invested in a corporation or partnership that meets the requirements to be certified as a qualified opportunity fund (QOF), as defined in § 1400Z-2(d)(1) and § 1.1400Z2(d)-1. If certain qualifications and holding period requirements are met, then (i) a portion of such deferred gains may be excluded from gross income, and (ii) gain on the taxpayer's investment of such amounts in a QOF may be excludable from gross income.

.02 References to §§ 1400Z-1 and 1400Z-2. All references hereinafter in this notice to "prior § 1400Z-1" and "prior § 1400Z-2" refer to §§ 1400Z-1 and 1400Z-2, as in effect after amendment of the Code by both § 13823 of Public Law 115-97, 131 Stat. 2054, 2183 (December 22, 2017), commonly known as the Tax Cuts and Jobs Act (TCJA), and by § 41115 of the Bipartisan Budget Act of 2018 (BBA 2018), Public Law 115-123, 132 Stat. 64, 161 (February 9, 2018), but prior to amendment by § 70421 of the OBBBA. All references in this notice to "§ 1400Z-1" and "§ 1400Z-2" refer to §§ 1400Z-1 and 1400Z-2 as amended by § 70421 of the OBBBA.

.03 Definitions

(1) Qualified Opportunity Zones. For purposes of §§ 1400Z-1 and 1400Z-2, § 1400Z-1(a) defines a QOZ as any population census tract that is a low-income community (LIC), as defined in § 1400Z-1(c)(1), that is designated as a QOZ. This notice refers to a QOZ designated under prior § 1400Z-1 as a "previously designated QOZ."

(2) Qualified Opportunity Fund. Section 1400Z-2(d)(1) provides that a QOF is an

investment vehicle that is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (QOZP), other than another QOF, that holds at least 90 percent of its assets in QOZP as measured on the dates described in § 1400Z-2(d)(1)(A) and (B) (90-percent investment standard). See § 1.1400Z2(a)-1(b)(4).

(3) Qualified opportunity zone property. Section 1400Z-2(d)(2)(A) defines QOZP as property that is qualified opportunity zone stock (QOZ stock), qualified opportunity zone partnership interest (QOZ partnership interest), or qualified opportunity zone business property (QOZBP).

(a) Qualified opportunity zone stock. Effective for stock acquired on or before December 31, 2026, prior § 1400Z-2(d)(2)(B) and the regulations thereunder define QOZ stock as any stock in a domestic corporation if: (i) the stock was acquired by a QOF at its original issue from the corporation solely in exchange for cash after December 31, 2017; (ii) the corporation was a qualified opportunity zone business (QOZB) (or newly organized for such purpose) at the time the stock was issued; and (iii) for 90 percent of the QOF's holding period of such stock, the corporation qualified as a QOZB. See prior §§ 1400Z-2(d)(2)(B) and 1.1400Z2(d)-1(c)(2)(i). Effective for stock acquired after December 31, 2026, § 70421(c)(4)(B) of the OBBBA modified § 1400Z-2(d)(2)(B)(i)(I) by replacing "December 31, 2017," with "applicable date," which, as defined in § 1400Z-2(d)(2)(E), means, with respect to any corporation that is a QOZB, the earliest applicable start date with respect to the QOZBP held by such QOZB. See paragraph (5) of this subsection for the definition of "applicable start date."

(b) Qualified opportunity zone partnership interest. Effective for partnership

interests acquired on or before December 31, 2026, prior § 1400Z-2(d)(2)(C) and the regulations thereunder define QOZ partnership interest as any capital or profits interest in a domestic partnership where: (i) the interest was acquired by a QOF from the partnership solely in exchange for cash after December 31, 2017; (ii) the partnership was a QOZB (or newly formed for such purpose) at the time the interest was acquired; and (iii) for 90 percent of the QOF's holding period of such interest, the partnership qualified as a QOZB. See prior § 1400Z-2(d)(2)(C) and § 1.1400Z2(d)-1(c)(3)(i).

Effective for partnership interests acquired after December 31, 2026, § 70421(c)(4)(B) of the OBBBA modified § 1400Z-2(d)(2)(C)(i) by replacing "December 31, 2017," with "applicable date" as defined in § 1400Z-2(d)(2)(E). Under § 1400Z-2(d)(2)(E), "applicable date" means, with respect to any partnership that is a QOZB, the earliest applicable start date with respect to the QOZBP held by such QOZB.

(c) Qualified opportunity zone business property. Effective for property acquired on or before December 31, 2026, prior § 1400Z-2(d)(2)(D) defines QOZBP as tangible property used in a trade or business of the QOF if (i) such property was acquired by the QOF by purchase after December 31, 2017, (ii) the original use of such property in the QOZ commences with the QOF or the QOF substantially improves the property, and (iii) during substantially all of the QOF's holding period for such property, substantially all of the use of such property was in a QOZ. Effective for property acquired after December 31, 2026, § 70421(c)(4)(A) of the OBBBA amended prior § 1400Z-2(d)(2)(D)(i)(I) by striking "December 31, 2017" at the end of the subclause and inserting "the applicable start date (as defined in § 1400Z-1(e)(2)) with respect to the [QOZ] described in" § 1400Z-2(d)(2)(D)(i)(III).

(4) Qualified opportunity zone business.

(a) In general. Section 1400Z-2(d)(3)(A) defines a QOZB as a trade or business in which substantially all of the tangible property owned or leased in connection with the trade or business is QOZBP. The trade or business must also satisfy the following requirements provided in § 1397C(b)(2), (4), and (8): (i) at least 50 percent of the total gross income of the entity must be derived from the active conduct of a trade or business in the QOZ; (ii) a substantial portion of the intangible property of such entity must be used in the active conduct of a trade or business in the QOZ; and (iii) less than five percent of the average of the aggregate unadjusted bases of the entity's property must be attributable to nonqualified financial property. Finally, a QOZB may not be a trade or business described in § 144(c)(6)(B). See also § 1.1400Z2(d)-1(d)(3).

(b) 70-percent tangible property standard. Section 1.1400Z2(d)-1(d)(1)(i) and (d)(2) clarify the "substantially all" requirement provided in § 1400Z-2(d)(3)(A)(i) regarding the amount of tangible property owned or leased by the taxpayer that is required to be QOZBP. Under the regulations, for an entity's trade or business to satisfy the "substantially all" requirement, at least 70 percent (by value) of the tangible property owned or leased by the trade or business must be QOZBP.

(5) Applicable start date and effective period. Section 70421(b)(2) of the OBBBA redesignated prior § 1400Z-1(f) as § 1400Z-1(e), and § 70421(b)(3) of the OBBBA modified when a QOZ designation period begins and ends for QOZs designated under § 1400Z-1. A QOZ designation period under § 1400Z-1(e)(1) begins on the applicable start date and ends on the day before the date that is 10 years after the applicable start date. Under § 1400Z-1(e)(2), the term "applicable start date" means, with respect to

any QOZ designated under § 1400Z-1, the January 1 following the date on which such QOZ was certified and designated. These provisions are effective only for areas certified and designated after the enactment of the OBBBA.

.04 Designations of QOZs.

(1) In General. Section 1400Z-1(b)(1) allows the Chief Executive Officer (CEO) of each State, territory of the United States, and the District of Columbia (State) to nominate LICs within their jurisdiction to be certified and designated by the Secretary of the Treasury or Secretary's delegate (Secretary) as QOZs. As described in section 3.01(1) of this notice, § 1400Z-1(d) limits the number of population census tracts in a State that the Secretary may designate as QOZs with respect to any designation period. See Rev. Proc. 2026-14, 2026-20 IRB 910, for guidance for State CEOs regarding nomination of a population census tract for designation as a QOZ effective on January 1, 2027.

(2) Designations of previously designated QOZs.

(a) In general. Under prior § 1400Z-1(c)(1), a population census tract was eligible for designation as a QOZ if it satisfied the definition of an LIC in § 45D(e). In addition, prior § 1400Z-1(e) provided that a population census tract that was not an LIC could be designated as a QOZ if, among other requirements, the tract was contiguous with an LIC that was designated as a QOZ. Rev. Proc. 2018-16, 2018-9 I.R.B. 383, provided guidance on the nomination, certification, and designation process under prior § 1400Z-1(b)(1) and (2). After the enactment of the TCJA, § 41115 of BBA 2018 created a special rule for Puerto Rico by adding prior § 1400Z-1(b)(3), under which all LICs in Puerto Rico were deemed certified and designated as QOZs effective on the

date of the enactment of the TCJA (that is, December 22, 2017).

(b) Notices 2018-48 and 2019-42. Notice 2018-48, 2018-28 I.R.B. 9, amplified by Notice 2019-42, 2019-29 I.R.B. 352, provides a list of LICs certified and designated as QOZs by the Secretary in 2018, as well as LICs in Puerto Rico deemed certified and designated as QOZs under prior § 1400Z-1(b)(3), effective on December 22, 2017. Notice 2019-42, 2019-29 I.R.B. 352, added two additional census tracts in Puerto Rico that were deemed certified and designated as QOZs under prior § 1400Z-1(b)(3) effective on December 22, 2017.

(c) Period for which designation is in effect. Prior § 1400Z-1(f) provided a 10-year “QOZ designation period” for which a population census tract, once designated as a QOZ, would remain designated, beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation. Accordingly, the QOZ designation period under prior § 1400Z-1(f) ends on—

(i) December 31, 2027, for QOZs deemed certified and designated in Puerto Rico under prior § 1400Z-1(b)(3), and

(ii) December 31, 2028, for all other QOZs.

### SECTION 3. TRANSITIONAL GUIDANCE REGARDING SECTION 1400Z-1

#### .01 QOZ designations under the OBBBA.

(1) Application of 25-percent limitation. Prior § 1400Z-1(d)(1) provided that, except as provided in prior § 1400Z-1(d)(2)<sup>2</sup> and (b)(3) (deemed designation rule for Puerto Rico), the number of designated QOZs may not exceed 25 percent of the total number

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<sup>2</sup> Prior § 1400Z-1(d)(2) provided that, notwithstanding the 25-percent limitation, if a State contains fewer than 100 LICs, then a total of 25 tracts that are LICs may be designated.

of LIC population census tracts in the State (25-percent limitation). Section 70421(a) of the OBBBA amended prior § 1400Z-1 to apply the 25-percent limitation on the number of QOZ designations made during any period. Specifically, § 70421(a)(4) of the OBBBA amended prior § 1400Z-1(d)(1) to remove the exception from the 25-percent limitation for Puerto Rico and amended prior § 1400Z-1(d)(1) and (2) to add references to “during any period.” For purposes of applying the 25-percent limitation on the number of population census tracts in a State that may be designated as QOZs by the Secretary, the phrase “during any period” refers to the QOZ designation period under § 1400Z-1(e)(1) beginning on the applicable start date and ending on the day before the date that is 10 years after the applicable start date during which an LIC is designated as a QOZ. Accordingly, the number of previously designated QOZs in a State will not affect the number of population census tracts that a State CEO may nominate to be designated as QOZs for the QOZ designation period beginning January 1, 2027.

(2) Applicable start date and designation period. Under § 1400Z-1(e)(2), the term “applicable start date” means, with respect to any QOZ designated under § 1400Z-1, the January 1 following the date on which such QOZ was certified and designated. Therefore, for every LIC certified and designated by the Secretary as a QOZ under § 1400Z-1(b) during 2026, the QOZ designation period begins on January 1, 2027, and ends on December 31, 2036.

#### SECTION 4. TRANSITIONAL GUIDANCE FOR INVESTORS

.01 Gain realized on or before December 31, 2026, and invested in a QOF on or before December 31, 2026.

(1) In general. Under § 1400Z-2(a)(1)(A) and § 1.1400Z2(a)-1, in the case of a

taxpayer with one or more eligible gains, as defined in § 1.1400Z2(a)-1(b)(11), at the election of the taxpayer, gross income for the taxable year will not include the aggregate amount of such gain invested by the taxpayer in a QOF during the 180-day period beginning on the date of the events that gave rise to that gain. Prior § 1400Z-2(b)(1)(B) and § 1.1400Z2(b)-1(b) provide that if gain was deferred by reason of an election under § 1400Z-2(a) for a timely qualifying investment made on or before December 31, 2026, then such gain must be included in the taxpayer's gross income in the taxable year that includes the earlier of (i) the date on which an inclusion event, as defined in § 1.1400Z2(b)-1(c), occurs with respect to such qualifying investment (or portion thereof), or (ii) December 31, 2026.

(2) Inability to make a deferral election for taxpayers holding qualifying investments through December 31, 2026. Taxpayers holding a qualifying investment (or portion thereof) through December 31, 2026, are required to include in income in the taxable year that includes that date the amount of remaining deferred gain from the qualifying investment as calculated under prior § 1400Z-2(b)(2) and § 1.1400Z2(b)-1(e)(3) (deemed included gain). Taxpayers that recognize deemed included gain on December 31, 2026, continue to hold a qualifying investment for which an election under § 1400Z-2(a) remains in effect. See § 1400Z-2(e)(1)(A), §§ 1.1400Z2(a)-1(b)(34) and 1.1400Z2(c)-1(b)(1)(i). Amounts of deemed included gain may not be deferred pursuant to either prior or current § 1400Z-2(a)(1)(A) because, as noted above, an election continues to be in effect under prior and current § 1400Z-2(a)(2) with respect to the eligible gain that gave rise to the deemed included gain on December 31, 2026. Thus, no amount of deemed included gain can be eligible gain with respect to which an

election under either prior or current § 1400Z-2(a) may be made.

(3) Continued eligibility to make an election under § 1400Z-2(c). Because the election under § 1400Z-2(a) with respect to a qualifying investment continues in effect when an eligible taxpayer recognizes deemed included gain in the taxable year which includes December 31, 2026, under prior § 1400Z-2(b)(1)(B) and § 1.1400Z2(b)-1(b)(2), the taxpayer remains potentially eligible to make an election under § 1400Z-2(c) on the later sale or exchange of that qualifying investment. (The election under § 1400Z-2(c) can be made only if the taxpayer satisfies the 10-year holding period requirement and the other requirements of § 1400Z-2 and the regulations thereunder through the date on which the investment is disposed of. See § 1.1400Z2(c)-1(b)(1)(i).)

.02 Gain realized on or before December 31, 2026, and invested in a QOF on or after January 1, 2027.

(1) In general. Section 70421(c)(1) of the OBBBA modified prior § 1400Z-2(a)(2) by allowing a deferral election to be made after December 31, 2026. In addition, § 70421(c)(2) of the OBBBA modified prior § 1400Z-2(b) in multiple ways, including by changing the taxable year of inclusion in prior § 1400Z-2(b)(1)(B) from that which includes December 31, 2026, to that which includes the date that is 5 years after the date the qualifying investment was made. Under § 1400Z-2(b)(2)(B), if a qualifying investment is held for at least five years, a taxpayer's basis in the qualifying investment increases by 10 percent (or 30 percent, in the case of any investment in a qualified rural opportunity fund), as defined in § 1400Z-2(b)(2)(C)). Section 1400Z-2(b)(2)(B) and (C) are effective for amounts invested in QOFs after December 31, 2026. See § 70421(c)(5)(A) of the OBBBA.

(2) Gain eligible for deferral. In the case of a taxpayer 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 taxpayer may elect to defer the recognition of that gain provided the requirements under § 1400Z-2(a) are met. See § 1.1400Z2(a)-1(b)(7) for guidance on what is considered a timely investment. The deferred gain with respect to a qualifying investment made on or after January 1, 2027, must be included in gross income in the taxable year that includes the earliest of (i) the date on which such qualifying investment (or portion thereof) is sold or exchanged, (ii) the date on which an inclusion event other than a sale or exchange occurs with respect to such qualifying investment (or portion thereof), or (iii) five years from the date the qualifying investment was made. Section 1400Z-2(b)(2)(B) provides for the determination of basis for purposes of determining the amount of gain included in gross income.

.03 Eligibility of inclusion event gain.

(1) In general. Under § 1.1400Z2(a)-1(b)(11)(iv)(A), gain with respect to a qualifying investment (or portion thereof) that is otherwise required to be included in gross income due to the occurrence of an inclusion event (inclusion event gain) may be eligible for deferral under § 1400Z-2(a)(1), provided that all of the requirements to elect to defer eligible gain under § 1400Z-2(a)(1)(A) are met. For purposes of determining whether inclusion event gain is eligible gain under § 1400Z-2(a)(1)(A), such inclusion event gain is treated as if it were realized upon the occurrence of the inclusion event rather than on the sale or exchange that gave rise to the eligible gain to which the inclusion event relates. See § 1.1400Z2(a)-1(b)(11)(iv).

(2) Requirements to defer inclusion event gain under § 1400Z-2(a). Inclusion

event gain may be deferred by making a qualifying investment within 180 days of the inclusion event date. See § 1.1400Z2(a)-1(b)(11)(iv)(B). To the extent a taxpayer has an inclusion event with respect to any portion of a qualifying investment, that portion is no longer a qualifying investment and the taxpayer is not eligible to make an election pursuant to § 1400Z-2(c) with respect to that portion of the qualifying investment. For guidance on the treatment of the portion of a qualifying investment to which an inclusion event relates and the inability to make an election under § 1400Z-2(c) with respect to that portion of the investment, see § 1.1400Z2(c)-1(b)(1)(i).

## SECTION 5. TRANSITIONAL GUIDANCE FOR QOFS AND QOZBS

### .01 Tangible property acquired after December 31, 2026.

(1) In general. In order for tangible property to meet the “acquired by purchase” requirement under § 1400Z-2(d)(2)(D)(i)(I), such property must be purchased, as defined in § 179(d)(2), after the applicable start date, as defined in § 1400Z-1(e)(2), with respect to the QOZ (that is, January 1 following the date on which such QOZ was certified and designated as a QOZ). The amendment to the language in prior § 1400Z-2(d)(2)(D)(i)(I) by § 70421(c)(4)(A) of the OBBBA, from property acquired by purchase after “December 31, 2017” to property acquired by purchase after the “applicable start date,” applies to any property acquired after December 31, 2026. See § 70421(c)(5)(B) of the OBBBA. Thus, § 1400Z-1(e)(2)’s definition of “applicable start date” is effective only for a QOZ designated after the date of enactment of the OBBBA. See § 70421(b)(4) of the OBBBA. A previously designated QOZ does not have an “applicable start date” under § 1400Z-1(e)(2) because its designation took place before the date of enactment of OBBBA. Therefore, property acquired by a QOF or QOZB

after December 31, 2026, cannot be QOZBP unless (i) the property is acquired for use in a QOZ that is designated after July 4, 2025, or (ii) one of the exceptions in section 5.01(2) and (3) of this notice applies.

(2) Property acquired pursuant to a working capital safe harbor plan after December 31, 2026.

(a) In general. Section 1400Z-2(d)(3)(A)(ii) incorporates § 1397C(b)(8), which requires that less than 5 percent of the average of the aggregate unadjusted bases of the property of the relevant entity be attributable to nonqualified financial property in each taxable year. In general, under § 1397C(e), “nonqualified financial property” means debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property specified in regulations. However, under § 1397C(e)(1), this term does not include reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less. For purposes of applying § 1397C(e)(1) to a QOZB under § 1400Z-2(d)(3), § 1.1400Z2(d)-1(d)(3)(v) provides a safe harbor under which working capital assets are treated as reasonable in amount if the following requirements, provided in § 1.1400Z2(d)-1(d)(3)(v)(A) through (C), are satisfied. First, the working capital assets must be designated in writing for the development of a trade or business in a QOZ, including when appropriate the acquisition, construction, and/or substantial improvement of tangible property in the QOZ. Second, there must be a written schedule consistent with the ordinary start-up of a trade or business for expenditure of those working capital assets. Under the schedule, the working capital assets must be spent within 31 months of the receipt by the business of the assets. Third, the working

capital assets must be used in a manner that is substantially consistent with the writing and the written schedule. A single business may benefit from more than a single application of the working capital safe harbor, provided that each application independently satisfies all of the requirements of § 1.1400Z2(d)-1(d)(3)(v)(A) through (C). See § 1.1400Z2(d)-1(d)(3)(v)(E). Additionally, pursuant to a working capital safe harbor for start-up businesses that are not yet operating as a trade or business, these entities may treat certain amounts as satisfying the requirements for QOZB qualification under § 1400Z-2(d)(3)(i) for the duration of the working capital safe harbor. See § 1.1400Z2(d)-1(d)(3)(vi).

(b) Transition guidance regarding QOZBP. If an entity acquires property after December 31, 2026, for use in a previously designated QOZ and pursuant to a written plan meeting the requirements of the § 1.1400Z2(d)-1(d)(3)(v) and (vi) working capital safe harbors, then that property may satisfy the acquisition requirement of § 1400Z-2(d)(2)(D)(i)(I) 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 ten percent 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 five percent 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 requirement to expend five percent of the total estimated working capital assets by December 31, 2026.

(c) Transition guidance regarding QOZP. Stock or partnership interests acquired

after December 31, 2026, pursuant to a written plan described in this section 5.01(2), are treated as acquired after the “applicable date” for purposes of § 1400Z-2(d)(2)(B)(i)(I) and § 1400Z-2(d)(2)(C)(i).

(3) Tangible property acquired in the ordinary course of business after December 31, 2026, for use in a previously designated QOZ. Tangible property acquired after December 31, 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 if the requirements of § 1400Z-2(d)(2)(D) are otherwise met. 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.

(4) Examples. The following examples illustrate the application of the provisions in section 5.01(1) through (3) of this notice.

(i) Example 1—Tangible property acquired pursuant to the expansion of a trade or business. QOZB A owns and operates an industrial manufacturing facility in Tract A, which was designated as a QOZ in 2018 under prior § 1400Z-1. On June 15, 2028, QOZB A purchases a new warehouse on an adjacent plot of land from an unrelated third party to expand the facility’s capacity to produce a new product. The new warehouse acquired by QOZB A on that date is not located in a tract that was designated as a QOZ effective January 1, 2027. Because the new warehouse was not acquired after the applicable start date of a tract designated as a QOZ on January 1,

2027, it is not QOZBP under the general rule in section 5.01(1) of this notice. Because the new warehouse was not developed pursuant to a written plan within the scope of section 5.01(2) of this notice and was acquired pursuant to the expansion of QOZB A's trade or business within the meaning of section 5.01(3) of this notice, it cannot qualify as QOZBP.

(ii) Example 2—Replacement of existing tangible business property in the ordinary course of the trade or business. QOZB A owns and operates an apartment building that is QOZBP in Tract B, which was designated as a QOZ in 2018 under prior § 1400Z-1. The apartment building is not located in a tract that was designated as a QOZ effective January 1, 2027. In 2028 and in 2029, the apartment building requires window replacements and the purchase of replacement appliances, fixtures, cabinetry, flooring, and similar tangible property pursuant to the renovation of apartment units when tenants vacate the premises. These acquisitions are necessary for the continued operation of the apartment building and are replacements in the ordinary course of business that qualify as QOZBP under § 1400Z-2(d)(2)(D). See section 5.01(3) of this notice.

(iii) Example 3—Modernization of property necessary to continue the operations of the trade or business. QOZB C operates a trade or business as a restaurant in Tract D, which was designated as a QOZ in 2018 under prior § 1400Z-1. The restaurant is not located in a tract that was designated as a QOZ effective January 1, 2027. In 2028, in order to maintain operations and embrace industry advancements, the restaurant renovates and modernizes its kitchen, including adding a new ventilation system to its kitchen to improve energy efficiency and replacing its point-of-sale system

for a system with tools tailored specifically for the restaurant. The renovation and modernization of the kitchen are necessary for the continued operation of the restaurant in an efficient manner and are replacements in the ordinary course of business that qualify as QOZBP under § 1400Z-2(d)(2)(D). See section 5.01(3) of this notice.

(iv) Example 4—Property acquired pursuant to a working capital safe harbor plan adopted prior to December 31, 2026. QOF A forms domestic C corporation B (QOZB B) to develop a large mixed-use real estate development that will consist of commercial and residential real property. QOZB B has a master written plan for the completion of the commercial and residential developments over a 55-month period that is estimated to cost \$50 million with \$30 million allocated to the initial commercial development phase and \$20 million allocated to the subsequent residential development phase. The plan provides that the commercial development will be completed over a 30-month schedule, ending on November 30, 2026, and subsequently, the residential development will be completed over a 25-month schedule, estimated to be completed by December 31, 2028. The plan further provides that a portion of the commercial development is unable to be used in a trade or business after the completion of the commercial development since that portion of the commercial development will be unusable during the residential construction phase. On May 1, 2024, QOF A acquires stock of QOZB B in exchange for cash of \$30 million. QOZB B expends the full \$30 million in completing the commercial development by December 2026. Pursuant to QOZB B's original master plan for the completion of the real estate development, QOF A acquires additional stock in QOZB B for cash in December 2026, and QOZB B begins to use the cash for the residential development phase in early 2027. The development

is located in Tract D, which was designated as a QOZ in 2018 under prior § 1400Z-1. The development is not located in a tract that was designated as a QOZ effective January 1, 2027. The mixed-use development satisfies the safe harbor in section 5.01(2) and acquisitions of tangible property made pursuant to the plan may qualify as QOZBP if they are made in a manner substantially consistent with the plan.

(v) Example 5— Property acquired pursuant to a working capital safe harbor plan adopted prior to December 31, 2026. The facts are the same as example 4, except that in November 2027 it becomes apparent that the residential development is over budget, delayed by three months, and will require additional capital to complete a portion of the residential development that includes a swimming pool for use by apartment residents. In December 2027, QOF A acquires additional stock of QOZB B solely in exchange for cash. The cash received by QOZB B in December 2027 is expended in accordance with the initial master plan established in 2024 to complete the residential apartment complex, including the completion of the swimming pool. The residential development is completed and placed into service by March 2029. The swimming pool was an integral part of the initial master plan established by QOZB B in May 2024. See § 1.1400Z2(d)-1(d)(3)(vi)(A). The commercial and residential real property may qualify as QOZBP assuming the other requirements of § 1400Z-2(d)(2)(D) are met. Because the stock was acquired in exchange for cash needed to complete development of the project, it may be treated as having been acquired after the applicable date pursuant to section 5.01(2)(c) of this notice.

.02 Compliance tests after a QOZ designation period ends.

(1) In general. Section 70421(c)(3) of the OBBBA amended prior § 1400Z-2(c) by

providing that, in the case of any qualifying investment held by the taxpayer for at least 10 years and with respect to which the taxpayer makes an election under that subsection, the basis of such qualifying investment equals its fair market value on the earlier of (i) the date such qualifying investment is sold or exchanged, or (ii) the date that is 30 years after the date of that qualifying investment. Section 1400Z-2(c) is effective for amounts invested in QOFs after December 31, 2026. See § 70421(c)(5)(A) of the OBBBA. Prior § 1400Z-2(c) allowed a taxpayer holding a qualifying investment for at least 10 years to make an election under prior § 1400Z-2(c) to adjust the basis of the property equal to the fair market value of that qualifying investment on the date that qualifying investment was sold or exchanged (without regard to the number of years that have passed since the date of the qualifying investment). Section 1.1400Z2(c)-1(c) provides that, for dispositions occurring before January 1, 2048, the ability to make an election under prior § 1400Z-2(c) for qualifying investments held for at least 10 years is not impaired solely because, under § 1400Z-1(f), the designation of one or more QOZs ceases to be in effect. See also § 1.1400Z2(c)-1(d), *Example 1*. Section 1400Z-2(d) contains multiple requirements the satisfaction of which are dependent on whether property owned by a QOF or QOZB, or a trade or business engaged in by a QOF or QOZB, is located in a QOZ. Given that § 1400Z-2(c) and § 1.1400Z2(c)-1(c) contemplate the ability to continue a qualifying investment made in a QOZ after its designation as a QOZ ceases to be in effect, the Treasury Department and the IRS expect that the forthcoming proposed regulations will include the following safe harbors for QOFs and QOZBs to continue to satisfy these requirements after the expiration of a QOZ's designation period.

(2) Substantial use element of the definition of QOZBP. For tangible property to qualify as QOZBP, substantially all of the use of that property must be in a QOZ for substantially all of the entity's holding period for such property. See § 1400Z-2(d)(2)(D)(i)(III); see *also* § 1.1400Z2(a)-1(b)(3). If property otherwise qualifies as QOZBP, a QOF or QOZB that acquires that property on or before the expiration of its QOZ designation period (December 31, 2027, or December 31, 2028, as applicable), or pursuant to sections 5.01(2) or 5.01(3) of this notice, may continue to treat a previously designated QOZ the designation of which has expired as a QOZ solely for purposes of § 1400Z-2(d)(2)(D)(i)(III) through December 31, 2047.

(3) QOZB Compliance Tests. For an entity to qualify as a QOZB, at least 50 percent of its gross income must be derived from the active conduct of a trade or business in a QOZ, and a substantial portion of its intangible property must be used in the active conduct of a trade or business in a QOZ. See § 1400Z-2(d)(3)(A)(ii); see *also* § 1.1400Z2(d)-1(d)(3)(i) and (ii). A QOZB that has begun to engage in the active conduct of a trade or business within a previously designated QOZ on or before the expiration of its QOZ designation period (December 31, 2027, or December 31, 2028, as applicable), or that reasonably anticipates to begin doing so in accordance with a written plan that meets the requirements of section 5.01(2) of this notice, may continue to treat a previously designated QOZ the designation of which has expired as a QOZ solely for the purposes of § 1400Z-2(d)(3)(A)(ii) through December 31, 2047.

## SECTION 6. APPLICABILITY DATE

The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will propose that the final regulations, once published in the Federal

Register, would apply to taxable years ending after the date this notice is issued to the public. See § 7805(b)(1)(C).

#### SECTION 7. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Maria Castillo Valle of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Castillo Valle at (202) 317-7006 (not a toll-free number).