



Tax Insights  
from Real Estate and  
Infrastructure

# IRS provides transitional guidance on Opportunity Zone changes

June 25, 2026

## In brief

### What happened?

The Treasury Department and the IRS released [Notice 2026-40](#) on June 18, 2026, announcing their intent to issue proposed regulations addressing qualified opportunity zones (QOZs) under Sections 1400Z-1 and 1400Z-2, as amended by the One Big Beautiful Bill Act (OBBBA). The notice provides transitional guidance related to qualifying investments, QOZ designations, investor deferral elections, post-2026 property acquisitions, and compliance testing after existing QOZ designations expire.

### Why is it relevant?

Notice 2026-40 provides important guidance for taxpayers with existing QOF investments, investors considering transactions near year-end 2026, and qualified opportunity funds (QOFs) and qualified opportunity zone businesses (QOZBs) with projects located in currently designated QOZs that may not be redesignated under the permanent QOZ tax incentive. The notice clarifies that capital gains deferred under the original OZ program that are required to be recognized on December 31, 2026 may not be re-deferred, while certain other gains realized in 2026 or triggered by inclusion events may be eligible for the revised post-2026 QOZ benefits if timely invested in a QOF on or after January 1, 2027.

### Actions to consider

Taxpayers should review existing QOF investments and planned QOZ projects in light of the transition rules described in Notice 2026-40. Investors with eligible gains realized in 2026 should consider the timing of QOF investments, while QOFs and QOZBs should assess whether post-2026 property

acquisitions in existing QOZs may qualify under the working capital safe harbor or ordinary course replacement property exceptions. Sponsors also should evaluate whether current projects will satisfy the requirements for continued location-based compliance after the applicable QOZ designation period expires.

QOZBs with multi-phase projects in existing QOZs should take note of the December 31, 2026 deadlines embedded in the working capital safe harbor transition rule, as the written plan must be adopted, at least 10% of total estimated working capital assets must be received, and at least 5% must be expended (or subject to a binding commitment) by that date. Projects currently in process that have not satisfied these thresholds may lose access to the working capital transition rule, with significant consequences for QOZ business property (QOZBP) qualification on future property acquisitions.

## In detail

### Overview

The QOZ tax incentive was first enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA) to promote investment in economically distressed communities by allowing taxpayers to defer eligible capital gains invested in QOFs and, if applicable requirements are satisfied, exclude gain on the disposition of qualifying QOF investments held for at least 10 years. The OBBBA made the QOZ tax incentive permanent and modified several core rules, including the designation process, investor deferral period, and basis increase rules, while also adding rural opportunity fund benefits (including an enhanced 30% basis step-up for investments in qualified rural opportunity funds held for at least five years, compared to the standard 10% step-up) and increased reporting requirements.

Notice 2026-40 announces that Treasury and the IRS intend to issue proposed regulations implementing transitional rules for the amended QOZ provisions. The forthcoming proposed regulations are expected to include rules similar to those described in the notice, with a proposed applicability date for tax years ending after June 18, 2026, the date the notice was issued.

### Transitional guidance regarding QOZ designations

Notice 2026-40 clarifies that the 25% limitation on the number of low-income community census tracts that may be designated as QOZs applies separately for each QOZ designation period. As a result, previously designated QOZs that remain in effect through December 31, 2028 (or December 31, 2027, for QOZs located in Puerto Rico) generally will not reduce the number of tracts that a state, territory, or the District of Columbia may nominate for the designation period beginning January 1, 2027.

**Observation:** This clarification is significant for states and territories preparing nominations for the first designation period under the permanent QOZ tax incentive. The ability to nominate new tracts without regard to existing QOZs may allow jurisdictions to focus on census tracts that satisfy the revised eligibility requirements without being constrained by designations made under the TCJA-enacted tax incentive.

### Transitional guidance for investors

#### Gains deferred under the original OZ program recognized on December 31, 2026

Taxpayers holding qualifying QOF investments through December 31, 2026 must include any remaining deferred gain in income for the tax year that includes that date. Notice 2026-40 refers to this amount as

“deemed included gain” and provides that such gain may not be deferred again under either the prior or amended QOZ rules because the original deferral election remains in effect with respect to the eligible gain that gave rise to the deemed inclusion. Importantly, because that election remains in effect, the investment continues to be a qualifying investment, and the taxpayer remains potentially eligible to make the basis step-up election under Section 1400Z-2(c) on a later sale or exchange, provided the 10-year holding period and the other applicable requirements are satisfied.

**Observation:** Investors should distinguish between gain that is mandatorily recognized on December 31, 2026 and other eligible gains that may be realized in 2026 (including gains resulting from inclusion events, as discussed further below). The notice confirms that the mandatory recognition of previously deferred gain does not create a new opportunity to restart the deferral period under the revised QOZ rules.

### Eligible gains invested on or after January 1, 2027

Notice 2026-40 provides that a taxpayer with eligible gain realized on, before, or after December 31, 2026 may elect to defer that gain if a corresponding amount is timely invested in a QOF on or after January 1, 2027 and the requirements of Section 1400Z-2(a) are otherwise satisfied. For qualifying investments made on or after January 1, 2027, the deferred gain generally must be included in income upon the earliest of a sale or exchange, another inclusion event, or the date five years after the qualifying investment was made. In addition, if such a qualifying investment is held for at least five years, the taxpayer’s basis in the investment increases by 10% (or 30% in the case of an investment in a qualified rural opportunity fund), effective for amounts invested in QOFs after December 31, 2026.

**Observation:** This rule may be particularly relevant for taxpayers with eligible gains realized late in 2026. Depending on the applicable 180-day investment period, those taxpayers may be able to invest in a QOF after December 31, 2026 and access the revised post-2026 QOZ benefits, including the rolling five-year deferral period and the five-year basis increase rules.

### Inclusion event gain

The notice also confirms that gain recognized as a result of an inclusion event may be eligible for deferral if the taxpayer makes a qualifying investment within 180 days of the inclusion event date and otherwise satisfies the applicable requirements. However, to the extent an inclusion event occurs with respect to any portion of a qualifying investment, that portion is no longer treated as a qualifying investment and the taxpayer cannot make the 10-year basis step-up election with respect to that portion of the original investment.

**Observation:** The treatment of inclusion event gain is generally consistent with the existing statute and regulations, but the timing of inclusion events occurring near the end of 2026 may be especially important as taxpayers evaluate whether the resulting gain can be invested under the permanent QOZ tax incentive.

## **Transitional guidance for QOFs and QOZBs**

### Post-2026 tangible property acquisitions

For tangible property acquired after December 31, 2026, Notice 2026-40 states that property generally must be acquired after the applicable start date of a QOZ designated after July 4, 2025 in order to satisfy the acquisition requirement for QOZBP. Because previously designated QOZs do not have an applicable

start date under the amended statute, post-2026 property acquisitions for use in those zones generally cannot qualify as QOZBP unless an exception applies.

**Observation:** This guidance may have a significant effect on projects in existing QOZs that are not redesignated under the new program. QOFs and QOZBs should review anticipated post-2026 acquisitions and determine whether they are tied to a qualifying transition rule or whether the project may need to be modified to preserve QOZ qualification. To the extent an existing QOZ is eligible for redesignation and a project may not otherwise meet one of the exceptions, QOF investors and sponsors may seek to work with state and local governments to advocate for why these tracts are deserving of further consideration.

**Observation:** The guidance infers that QOFs and QOZBs formed after 2026 will not be eligible to invest into previously designated QOZs if they are not re-designated, as the exceptions available for post-2026 property acquisitions in previously designated QOZs require a mix of documentation and spending within the QOZ prior to January 1, 2027.

### Working capital safe harbor plans

Notice 2026-40 provides a transition rule for property acquired after December 31, 2026 for use in a previously designated QOZ pursuant to a working capital safe harbor plan. The property may satisfy the acquisition requirement if the plan was adopted on or before December 31, 2026, the acquisitions are made in a manner substantially consistent with that plan, the QOZB received at least 10% of the total estimated working capital assets by December 31, 2026, and the QOZB expended at least 5% of the total estimated working capital assets by that date. Amounts required to be expended under a binding agreement entered into before January 1, 2027 are treated as expended for purposes of the 5% requirement.

The notice further provides that stock or partnership interests acquired after December 31, 2026 pursuant to such a plan are treated as acquired after the applicable date for purposes of determining whether the stock or partnership interest qualifies as QOZ property.

**Observation:** Without this rule, equity interests acquired by a QOF in a QOZB after December 31, 2026 could fail to qualify as QOZ property even where the underlying QOZB is operating in a previously designated QOZ and otherwise satisfies the transition rules. Sponsors of fund structures with multi-phase projects in existing QOZs should consider whether additional QOF capital contributions to their QOZBs after December 31, 2026 fall within the scope of this transition rule.

**Observation:** QOZBs with multi-phase projects in existing QOZs should evaluate whether their written plans, capital receipts, expenditures, and binding commitments satisfy the transition rule. The notice places particular importance on actions taken on or before December 31, 2026.

### Ordinary course replacement property

A separate transition rule applies to 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. The notice states that replacements in the ordinary course include replacement or modernization of property necessary to continue operations, but do not include property acquired to expand a trade or business or transition into a new trade or business.

**Observation:** This exception could provide practical relief for operating businesses and real estate projects that need to replace or modernize existing property after 2026. However, the distinction between

replacement or modernization and expansion will be important, particularly for projects that involve new property, additional capacity, or changes in business use.

## Compliance tests after a QOZ designation period expires

Notice 2026-40 states that forthcoming proposed regulations are expected to include safe harbors allowing QOFs and QOZBs to continue satisfying certain location-based requirements after a previously designated QOZ's designation period expires. For tangible property acquired on or before the expiration of the applicable QOZ designation period, or pursuant to the working capital or ordinary course replacement property transition rules, the QOF or QOZB may continue to treat the previously designated QOZ as a QOZ for purposes of the substantially all use requirement through December 31, 2047.

Similarly, a QOZB that began the active conduct of a trade or business in a previously designated QOZ before the designation period expired, or that reasonably anticipates beginning such operations pursuant to a qualifying written working capital plan, may continue to treat the area as a QOZ for purposes of the gross income and intangible property tests through December 31, 2047.

**Observation:** These safe harbors are intended to preserve the ability of qualifying investors to continue holding QOF investments after an existing QOZ designation expires. QOFs and QOZBs should nevertheless continue monitoring compliance with the relevant QOZ rules, including whether property was acquired by the applicable deadline or under one of the transition rules described in the notice.

## Applicability date

Treasury and the IRS anticipate that the forthcoming proposed regulations will propose that final regulations, once published in the Federal Register, apply to tax years ending after the date Notice 2026-40 was issued to the public. Accordingly, taxpayers should consider the notice in evaluating transactions and compliance positions for tax years ending after June 18, 2026.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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