By Jason Glasser

Opportunity zones 2.0

New framework makes the program permanent, narrows eligibility criteria and introduces enhanced investor incentives

Congress has transformed qualified opportunity zones (QOZs) from a temporary tax incentive to a permanent wealth-planning tool. The updated framework, designed not only to channel private capital into economically distressed areas, but also makes the program permanent, narrows eligibility criteria and introduces enhanced investor incentives.

Originally enacted under the Tax Cuts and Jobs Act of 2017, QOZs offered preferential capital gains tax treatment to investors who deployed capital into designated census tracts. For investments involving real estate, the IRS requires investors to satisfy a "substantial improvement" test by investing an amount equal to the building's basis or taking on ground-up development.

With the enactment of the One Big Beautiful Bill Act (OBBBA), the QOZ program has been revised and will be permanent on Jan. 1, 2027. Four changes stand out:

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- **Enhanced tax incentives.** Capital gains can be deferred for five years, receive a 10 percent step-up in basis after the five-year holding period, and eliminate capital gains tax on appreciation from QOZ investments held for at least 10 years.
- **Program permanence.** QOZs will be redesignated every 10 years, replacing the static map established in 2018.
- **Tighter eligibility criteria.** Qualifying tracts must now meet a 70 percent median family income threshold, down from the prior 80 percent standard, reducing the number of eligible areas.
- **Enhanced reporting and compliance requirements.** Investors and policymakers will have greater visibility into capital deployed and outcomes.

These changes represent a fundamental shift, incorporating QOZs into long-term investment strategies. They are a powerful tool for investors who have realized significant capital gains and are seeking real estate investments to defer those gains and generate long-term tax-advantaged returns.

More than any individual tax provision, permanence is the most consequential change. Under the original framework, investors, developers, and fund managers operated against a shrinking timeline as the program approached expiration. QOZ 2.0 transforms QOZs from a temporary tax strategy into a durable capital allocation framework.

Several key dates will shape implementation. The legislative timeline specifies that in July 2026 governors may nominate up to 25 percent of their state's eligible census tracts. October 2026 is the nomination deadline for states. Come January 2027, new QOZ investment programs can accept and deploy capital into newly designated zones.

There were also changes made to standard capital gains and pass-through entity gains.

Standard (or direct) capital gains, the basic 180-day reinvestment rule continues to be the gating item. The investor generally must contribute eligible capital gain to a qualified OZ fund within 180 days of the gain realization date. Under QOZ 2.0, this timing becomes especially important because the enhanced post-2026 benefits apply only to eligible gains invested after Dec. 31, 2026. As a result, taxpayers realizing gains in 2026 need to be mindful of whether their 180-day window extends into 2027, because investments made in 2027 may qualify for the new rolling five-year deferral period and restored basis step-up, while investments made on or before Dec. 31, 2026 remain subject to the legacy QOZ 1.0 framework.

Pass-through entity gains recognized through partnerships, S corporations, trusts and other pass-through vehicles may offer more timing flexibility than direct gains. Depending on how the gain is reported and who makes the QOZ election, the 180-day period may be measured from the date the entity recognizes the gain, the final day of the entity's taxable year, or the un-extended due date of the entity's tax return. This flexibility is particularly relevant for QOZ 2.0 planning because a pass-through entity that realizes gain in 2026 may allow its owners to start their 180-day clock later, potentially pushing the reinvestment deadline into 2027. That can be valuable where investors want to preserve eligibility for the new OZ 2.0 regime rather than being forced into a late-2026 QOZ 1.0 investment with limited deferral value.

REBALANCING INCENTIVES

Critics of the original QOZ framework argued that some investments flowed into neighborhoods already experiencing economic momentum rather than the most distressed communities. QOZ 2.0 seeks to address those concerns by directing more capital toward harder-to-finance projects and underserved geographies. Investors can focus on opportunities backed by long-term demographic trends including housing, addressing the national shortage of places to live. Other significant investment opportunities include industrial warehouses, capitalizing on structural tailwinds around ecommerce growth and supply chain modernization.

Rural QOZs represent one of the most significant additions under QOZ 2.0. Under QOZ 2.0, rural investments may satisfy the substantial improvement requirement with improvements equal to only 50 percent of basis, making rehabilitation, adaptive reuse and repositioning projects more economically viable. Along with the reduced improvement threshold, investments may receive a 30 percent basis step-up after five years, triple the benefit under the standard QOZ framework. Yet enhanced incentives exist for a reason. Rural markets often lack diversified economic bases and sustained population growth, creating greater uncertainty around long-term demand, absorption and rent growth.

TIMELY OPPORTUNITY

Baby boomers, who own about 30 percent of small businesses in the United States, are entering a period of unprecedented liquidity. While many businesses will remain in the family, a significant number will be sold to new owners, creating substantial capital gains. QOZ 2.0 provides an effective way to redeploy capital into long-term investment while benefiting from favorable tax treatment on realized gains.

In addition, the resurgence of the U.S. startup ecosystem is creating a new generation of founders with concentrated, highly appreciated wealth. More than 60 U.S. startups achieved unicorn status in 2024, while the U.S. IPO market rebounded with 176 offerings raising $33 billion. QOZ 2.0 offers a compelling tool to diversify, defer taxes and fuel long-term economic development.

KEY CONCLUSIONS

QOZs are no longer temporary. By making the program permanent, refining eligibility standards, introducing enhanced rural incentives, and increasing transparency, QOZ 2.0 seeks to offer investors an improved framework while preserving its core objective: Directing private capital toward communities that need it most. The result is a more durable opportunity set to shape real estate investment strategies for years to come.

Drawing on more than a decade of qualified opportunity zone investing experience and an institutional platform trusted by the world's largest investors, Clarion Partners believes opportunity zone investments represent an attractive tax-advantaged strategy for newly realized capital gains, particularly as the U.S. commercial real estate market enters the next phase of its investment cycle.

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