DENTONS

The Qualified Opportunity Zone Program and Clean Energy: A New Era for Natural Gas, Solar, Wind, Energy Storage and Nuclear Projects

Introduction and Statement of Purpose

The Qualified Opportunity Zone program (the "Opportunity Zone Program"), first introduced in the 2017 Tax Cuts and Jobs Act and its subsequent rulemaking, was designed to spur economic development and job creation in low-income communities by offering investors significant federal tax incentives for development in those communities. With the passage of the One Big Beautiful Bill Act in 2025 (the "OBBBA"), the opportunity zone landscape has been reshaped, introducing new rules, enhanced benefits for rural investments, and a robust and technical reporting regime.

These changes are particularly significant for both traditional and clean energy projects, including natural gas, solar, wind, energy storage, and the rapidly advancing and increasingly important nuclear energy projects where capital-intensive infrastructure and long-term planning are essential. This article explores the evolution of the Opportunity Zone Program, particularly in light of the OBBBA's substantial changes. These changes impact all aspects of the Opportunity Zone Program, including the dedicated qualified opportunity zones ("QOZs") where all investment occurs, the OBBBA's newly established Qualified Rural Opportunity Funds ("QROFs"), and the unique opportunities and considerations for all clean energy stakeholders, including landlords, tenants, lenders, developers, investors, operators, and others. Given the clean energy industry's reliance on real property leasehold interests, this article also focuses on the potential benefits and statutory requirements that may impact clean energy projects with long tenancies.

The Past: Opportunity Zones from 2017 to Present

The original 2017 Opportunity Zone Program was created to channel private capital into low-income communities. Investors (including developers) could defer capital gains by reinvesting those gains in Qualified Opportunity Funds ("QOFs"), which in turn invested in real property-based QOZs. This framework provided three primary tax benefits:

1. **Deferred Capital Gains Tax.** Commencing in 2017, investors could defer tax payment on capital gains reinvested in a QOF until a deemed December 31, 2026, recognition event, requiring the tax on the deferred gains to be paid no later than 2027.
2. **Reduced Capital Gains Tax upon Payment.** Holding the QOF investment for at least five years resulted in a 10 percent increase in basis, with a further 5 percent increase after seven years, resulting in a potential 15 percent increase in basis and a corresponding reduction in tax.
3. **Elimination of Capital Gains Tax for Long-Term QOF Investments.** The original Opportunity Zone Program's primary benefit provided that if the QOF held an investment within a QOZ for at least 10 years, any appreciation on the QOF's investment was fully excluded from taxable income and taxable gain after that 10-year period to a maximum of 30 years.

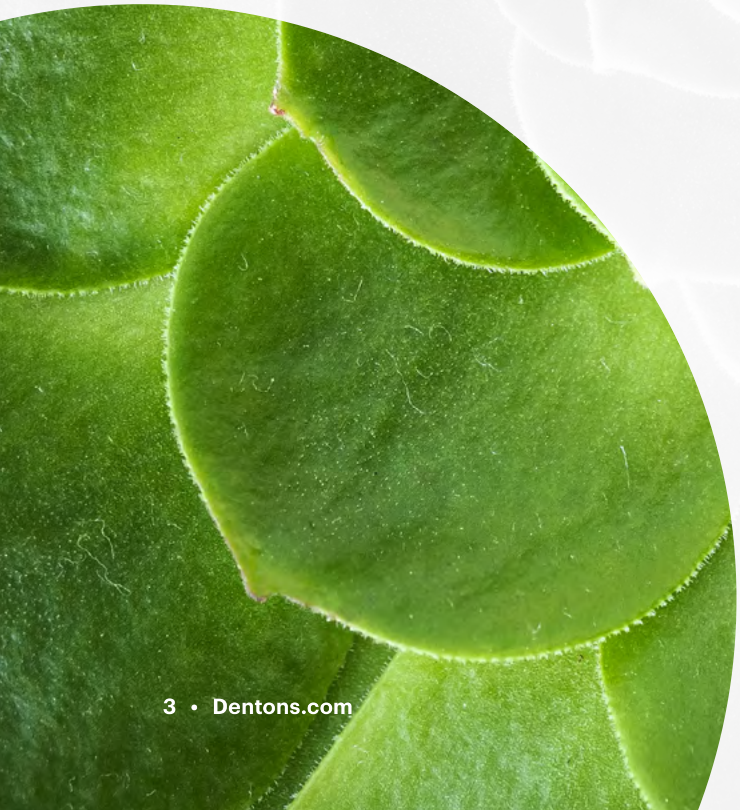
   For clean energy projects, these incentives provide a powerful tool to attract private capital to projects that might otherwise struggle to secure funding. The program, however, was set to expire for new investments on December 31, 2026, and the benefits were tied to a fixed timeline, limiting long-term planning and benefits as the 2026 date approached.

The Present: Changes to Opportunity Zones in the One Big Beautiful Bill

While retaining much of the structure and benefits from 2017, the OBBBA will, on a rolling basis between July 4, 2025, and December 31, 2026, implement certain nuanced changes which both limit and expand the scope, benefits, and requirements associated with the Opportunity Zone Program. Chief among those are the following:

1. **Permanent Extension, but with Decennial Zone Redesignation.** Simply put, the Opportunity Zone Program's expiration date is gone, and it is now, barring new federal law, a permanent part of the federal tax code without a sunset date. Every 10 years, states will reexamine and propose new and retained QOZs, with the US Treasury Secretary certifying those designations. Each QOZ will remain in effect for 10 years, providing a rolling window for new projects and investments. Given the income-based requirements for these zones, it is likely that zones will not change, but the potential exists in the new code.
2. **Modified Eligibility Criteria.** The definition of a "low-income community" has been tightened. Now, a census tract potentially qualifies for opportunity zone designation if its median family income does not exceed 70 percent of the state or metropolitan median, or if it has a poverty rate of at least 20 percent and a median family income not exceeding 125 percent of the relevant median. The controversial "contiguous tract" rule from 2017 has been eliminated, focusing investment more directly on areas of need.

3. **Rolling Gain Deferral and Stepped-Up Basis on Payment.** For QOF investments made after December 31, 2026, deferred gains will be recognized on the fifth anniversary of the investment date, rather than a fixed date. The 10 percent basis step-up at five years is now permanent, while the additional 5 percent step-up at seven years has been eliminated. In addition to the 10 percent reduction in the tax when paid, taxpayers also realize the time value of money associated with the tax they would have paid for the five-year deferral period.
4. **10-Year Holding Period and 30-Year Gain Window.** For investments held at least 10 years, the basis is stepped up to fair market value on the date of sale or, if not sold within 30 years, on the 30th anniversary of the investment. That means an owner or investor who holds the investment for longer than 30 years would appraise the property at such point with all gain up to that point excluded from income and tax. This replaces the previous sunset on gain exclusion, which was scheduled for December 31, 2047.
5. **New Reporting Requirements.** The OBBBA imposes new reporting and recordkeeping requirements. Those requirements are detailed below.



The Future: The Benefits of Opportunity Zones for Energy Projects

The Opportunity Zone Program's permanence and certain flexibility and focus on rural areas are particularly advantageous for clean energy projects, which often require long lead times and significant initial investment. This is particularly true given the expiration of existing tax credits applicable to clean energy projects in 2026 and 2027. All parties involved in clean energy projects should consider whether the Opportunity Zone Program may replace or augment existing, but expiring, tax credits.

The rolling decennial redesignation process allows developers to plan projects with greater certainty, knowing that benefits may be available for new projects in both previously and newly designated zones. The OBBBA does not address what occurs if a QOZ's designation changes mid-project, but that issue will likely be addressed in forthcoming Treasury rulemaking and guidance. The rolling gain deferral and basis step-up provisions align more closely with the typical investment horizons for energy infrastructure, making QOZs an attractive vehicle for energy developers and investors.

Additionally, recognizing that much of the original Opportunity Zone Program investment flowed to urban areas, the OBBBA introduced QROFs to drive capital into rural communities. QROFs must invest at least 90 percent of their assets in QOZ property located entirely within rural areas, defined as areas outside cities or towns with more than 50,000 people and not adjacent to urbanized areas. Investors in QROFs receive a 30 percent basis increase after five years, compared to 10 percent for standard QOFs. This results in a 30 percent reduction in tax, as opposed to 10 percent for QROFs, along with the traditional five-year deferral applicable to invested capital gain.

The energy sector—particularly clean energy projects—stands to benefit significantly from these changes and the permanent codification of the Opportunity Zone Program, particularly in rural areas where utility-scale energy projects are typically sited, land is more readily available, and community needs are often greater. The OBBBA and new QROF laws may be leveraged for such projects as follows:

1. **Benefits Include Leasehold Site Control.** Energy projects require large tracts of land, often involving multiple parcels. Though these benefits also exist in non-rural settings, the Opportunity Zone Program applies to both freehold and the more traditional leasehold site control interests in rural and urban zones. Many clean energy projects are developed on leased land rather than land owned by the developer or project company outright.

   The treatment of leasehold interests under the QOZ and QROF regimes is therefore critical. Investments in improvements to leased property, such as installing solar panels, constructing power plants, or building transmission infrastructure may qualify as "substantial improvement" for QOZ purposes. Under the OBBBA, the reduced substantial improvement threshold for QROFs (only 50 percent of the adjusted basis) makes it easier for energy developers to meet this requirement, even when the underlying land is leased. Additionally, energy projects often require long-term leases of 20, 30, or 40 years or more to ensure project viability. The QOZ and QROF rules accommodate long-term leaseholds, provided the lease is at market rate and not with a related party. Finally, at the end of the investment period, leasehold interests and improvements may be sold or transferred, allowing investors to realize gains that may be excluded from income if the holding period requirements are met.

2. **Ease in Meeting "Substantial Improvement" Test.** Energy projects involve significant infrastructure, such as pipelines, processing facilities, and power plants. The reduced substantial improvement requirement under QROFs makes it easier to qualify these investments, including through upgrades to existing facilities.

3. **Typical Rural Location.** Many energy projects are located in rural areas due to large-scale land availability and resource proximity. The enhanced basis step-up and other QROF benefits can make these projects more financially viable. This is particularly true as current tax incentives and benefits sunset in 2026 and 2027.

4. **Long-Term Investment Horizon Avoidance of All Project Gain upon Sale.** The 30-year gain window aligns well with the typical lifespan of energy projects, allowing investors to maximize tax benefits over the life of the asset, particularly upon sale when all profit may avoid taxation. If the investor, developer, or owner holds its investment for longer than 30 years, the applicable party may exclude the gain through 30 years by appraising the applicable property at that point.

5. **Particular Considerations as the Focus Shifts to Nuclear Projects.** New nuclear technologies, such as small modular reactors (*i.e.*, SMRs), may be deployed in rural areas. QROFs can provide critical capital for these high-cost, long-lead-time projects. Additionally, existing non-nuclear energy facilities, including coal plants, in QOZs or rural areas may qualify for substantial improvement under the new rules, supporting upgrades, conversions, and life extension projects as they transition to nuclear energy or, alternatively, continue their life as a traditional energy use. Finally, nuclear projects will bring high-quality jobs to rural communities, aligning with the Opportunity Zone Program's job creation goals.

6. **New, More Robust Reporting and Compliance Requirements.** With all its benefits, the OBBBA imposes new stringent reporting requirements on QOFs and QOZ businesses, including those involved in energy projects. QOFs must file annual returns, disclosing asset values, investment locations, NAICS codes, employment data, and more. For energy projects, this means detailed asset reporting, investment tracing, and careful tracking of employment data.

Summary and Recommendations

Most OBBBA changes to the Opportunity Zone Program take effect for investments and property acquired after December 31, 2026, giving the various stakeholders time to adapt, plan, and execute. For both energy stakeholders and community leaders, the new QOZ and QROF rules offer a unique opportunity to align financial incentives with national, state, and local clean energy and economic development goals. This is particularly true as existing tax and other incentives sunset and may be replaced by the permanence of and revisions to the Opportunity Zone Program. Interested stakeholders should consider, among other things, the following:

1. **Identify Eligible Sites.** Groups should utilize their professional, real estate, and lobbying efforts toward business, national, state, and local officials to identify QOZs and rural areas that align with project location needs.
2. **Properly Structure Investments.** Stakeholders should identify sources of capital gains and form or invest in QOFs, or their rural counterpart, QROFs, to maximize tax benefits for new energy projects.
3. **Leverage Leasehold Interests.** Structure lease agreements to ensure compliance with QOZ requirements and facilitate substantial improvement of leased property for long-term tax deferral, reduction, and avoidance.
4. **Make a Plan for Compliance.** Develop robust reporting systems to meet new annual filing requirements and demonstrate the economic and environmental impact of energy investments.
5. **Engage with Policymakers.** Participate in the decennial redesignation process to advocate for the inclusion of areas with strong clean energy potential.

Key Contacts

Andrew Rankin
Partner, Indianapolis
D+1 317 968 5452
andrew.rankin@dentons.com