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Opportunity Zones and Kentucky's P3 Statute: Providing the Potential Solution for Some of Kentucky's Infrastructure Needs

With Kentucky's recent enactment of legislation permitting public-private partnerships (P3s), as well as unsolicited proposals to state and local entities, private equity can now propose privately funded improvements to the state's infrastructure needs. Infrastructure improvements that are already needed or located within an Opportunity Zone are choice targets for developers and investors.

Opportunity Zones: What are the Incentives?

The federal opportunity zone tax incentive offers tax benefits intended to encourage investors in qualified opportunity funds (QO Funds) to access unrealized capital gain from their appreciated assets through a sale or other disposition and then use that gain to reinvest in projects in economically distressed areas the U.S. Treasury and IRS have designated Opportunity Zones.

Temporary Deferral

Investors can defer recognizing the reinvested capital gain as income until the end of the 2026 tax year under certain criteria. They must reinvest the gain in a QO Fund within 180 days of when that gain must be recognized for tax purposes (generally, when the asset is sold). However, special timing rules apply in limited situations.

Reduction of Deferred Gain

Because an investor in a QO Fund is acquiring an equity interest in the fund using tax deferred gain, the investor's initial basis in the investment is zero. Investors who hold an interest in the QO Fund for at least five years receive a 10% increase in their basis and a 15% increase if they own the interest for at least seven years.

Permanent Exclusion of Appreciation

Investors holding an interest in a QO Fund for at least ten years can elect to exclude any appreciation in the value of their interest above the amount of the original QO Fund investment when the interest is sold.

What property can a QO Fund own?

Whether partnership, LLC or corporation, a QO fund serves as a vehicle for investors to deploy capital into designated opportunity zones. At least 90% of the QO Fund's assets must consist of qualifying property—typically either an equity interest in a business operating in an Opportunity Zone (a QOZ Business) or tangible property used for trade or business activity in an Opportunity Zone (QOZB Property). At least 70% of the tangible property owned or leased by a QOZ Business must consist of QOZB Property.

If the original use of the qualified tangible property does not begin with the QO Fund or a qualifying business owned by the QO Fund, the fund or business is generally required to improve the property through capital investments exceeding the purchase price during the 30-month period after purchase

Public-Private Partnerships and Opportunity Zones

Although the number of P3 RFPs issued by state and local agencies has been less than what was hoped for, Kentucky has still seen a smattering of P3 projects over the past couple of years, in part because the P3 deal structure is already an attractive option for developers and investors.

With the refinement of Kentucky's P3 statute, savvy developers could take an already-attractive investment vehicle, add to it the potential benefits of Opportunity Zone tax incentives, and suddenly infrastructure projects previously thought to be incapable of finding financing may now suddenly be viable. Promisingly, this may solve the public's needs and provide excellent returns on private investment.

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