DUVAL & STACHENFELD LLP

COVID-19 Timing Relief for QOFs, QOZBs and Opportunity Zone Investors

D&S Opportunity Zone Practice Group
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Last week the IRS granted some very welcome relief to those in the Land of OZ as a result of the ongoing COVID-19 pandemic. The Opportunity Zone program (the "OZ Program") is riddled with deadlines and time-sensitive requirements, so the relaxation or extension of some of these provisions in IRS Notice 2020-39 should help at every level. Investors, fund managers, and developers each got some explicit timing relief.

1- Deadline for Investing Eligible Gains

Background: To get the full suite of OZ Program tax benefits,[1] a taxpayer must normally invest eligible gain into a qualified opportunity fund ("QOF") within 180 days from the date on which eligible gain is realized (the "180-Day Investment Period"). Additional timing rules apply to certain types of gain, such as gain allocated to a partner from a partnership. The 180-Day Investment Period for this "K-1 gain" can begin as late as the due date for the partnership's tax return (typically March 15th of the following year).

New Guidance and its Impact: Notice 2020-39 states that if a taxpayer's 180-Day Investment Period ends on or after April 1, 2020, and before December 31, 2020, the taxpayer now has until December 31, 2020, to invest eligible gain into a QOF.

This extension is critically important for potential investors. Given the stock sell-off in February and March of this year, an individual investor would normally have had to invest in a QOF by August or September. Depending on how quickly the economy picks up and whether there is a second wave of coronavirus infections over the summer, some investors may not be in a position to make investment decisions by then. They now have until December 31, 2020.

Similarly, the 180-Day Investment Period for investors with 2019 K-1 gains would have run out in early September of 2020. They also now have until December 31, 2020, to invest those 2019 K-1 gains into a QOF.

NOTE: This relief does not affect the deadline for the filing of Form 8949 and Form 8997 (the forms that an investor uses to elect the deferral associated with a QOF investment), which must be timely filed by the taxpayer with its federal income tax return. But even if this deadline is missed, the investor can still make the election in a subsequent amended return.

[1] For additional information on the OZ Program including tax benefits available to investors, see our Roadmap series.

2- 90% Asset Test for QOFs

Background: A QOF must hold at least 90% of its assets in qualified opportunity zone property ("QOZP"), which is tested by averaging the percentages of QOZP measured on the last day of the first half of the taxable year and on the last day of the taxable year of the QOF, typically June 30th and December 31st ("QOF Testing Dates"). Cash is not QOZP, so a QOF has to invest its cash contributions relatively quickly. If a QOF fails to meet the 90% asset test, a penalty is imposed on the value of the QOF's assets that cause it to be out of compliance. However, no penalty is imposed if the failure is due to reasonable cause.

New Guidance and its Impact: If either of the QOF Testing Dates falls within the period beginning on April 1, 2020, and ending on December 31, 2020, any failure by the QOF to meet the 90% asset test is automatically deemed to be due to reasonable cause, so there will be no penalty imposed on the QOF.

This relief was one of the most sought-after provisions by QOFs as a result of the pandemic. QOFs that had planned to invest in qualifying property in the spring or early summer of 2020 were almost universally forced to delay, reschedule or abandon closings altogether. This blanket reasonable cause relief gives QOFs until June 2021 before they have to worry about a QOF Testing Date.

NOTE: QOFs must still timely file Form 8996 for 2020, and they must accurately complete all lines on that form including percentage of QOZP. However, in Part IV, Line 8 (Penalty) of Form 8996, a QOF should put a "0" since a penalty would otherwise be imposed for any failures.

3- Extension of 30-Month Substantial Improvement Period

Background: If a QOZB acquires existing property, the property will only be qualifying tangible property to the QOZB if the property is substantially improved during a 30-month period beginning from the acquisition of the property (the "Substantial Improvement Test"). Property can meet the Substantial Improvement Test if the QOZB doubles its basis in the acquired improvements within the 30-month period (the basis attributable to the acquired land is ignored for purposes of this test).

New Guidance and its Impact: The period beginning on April 1, 2020 and ending on December 31, 2020 is now disregarded for purposes of meeting the Substantial Improvement Test. Any QOZB that was in the midst of its 30-month substantial improvement period on April 1 now has a 39-month substantial improvement period.

Although construction has continued in certain markets during the pandemic, most projects have seen some sort of delay or even an outright forced stop to construction, so this relief will be hugely helpful to improvement projects in Opportunity Zones.

4- Tolling of 31-Month Working Capital Safe Harbor

Background: The final Treasury Regulations to the OZ Program contain several relief measures applicable upon the declaration of a federal disaster. One of these measures allows a QOZB to toll its 31-month working capital safe harbor ("WCSH") period by not more than 24 months in the event of a federal disaster.

New Guidance and its Impact: The IRS confirmed that the Emergency Declaration in March 2020 triggers the federal disaster provisions in the regulations.

All QOZBs with working capital assets intended to be covered by a WCSH before December 31, 2020 receive not more than an additional 24 months to spend the working capital. One issue still up in the air is whether all QOZBs automatically receive a full 24 months for their WCSH, or whether QOZBs must show evidence of an actual delay. Until this is sorted out, our prior advice still stands – *DOCUMENT EVERYTHING*. Keep track of: (i) when you had to shut down your office, (ii) when various government offices where you submitted applications were closed, (iii) when you got notice that your architect, contractor, or consultant had to close their offices or stop working, and (iv) when shelter in place or lockdown orders that affect your project were issued. If you need to show an actual delay, you will want all of this information collected so you can count up the days.

5- Extension of Reinvestment Period

Background: A QOF that receives proceeds from either a sale of property or the return of capital typically has 12 months to reinvest those proceeds without including those amounts for purposes of its 90% test. In the event of a federal disaster, a QOF can have an additional 12 months added to its reinvestment period.

New Guidance and its Impact: Since the Emergency Declaration in March 2020 triggered the federal disaster provisions in the regulations, a QOF with a 12-month reinvestment period that includes January 20, 2020 now has an additional 12 months to reinvest those proceeds.

The D&S Opportunity Zone Practice Group brings together a 50-person team, including lawyers, paralegals, and our business professionals providing a unique value add for clients. The OZ team is led by:

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