Relief for Taxpayers Investing in QOFs

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The COVID-19 pandemic has dramatically impacted the economy and has disrupted numerous deals and investments.

Several tax incentives require taxpayers to take particular actions within a specific time frame. In particular, taxpayers must meet certain benchmarks within certain timeframes to obtain the tax benefits of qualified opportunity zone funds ("QOFs"). Because of the pandemic, taxpayers may have difficulty complying with the requirements necessary to obtain the benefit of investing in QOFs. Recently, the IRS issued Notice 2020-39 (the "Notice"), which provides relief for taxpayers investing in QOFs.

Deadline to Invest in QOFs

Typically, a taxpayer has 180 days from the date the taxpayer realizes capital gains to invest that gain into a QOF. If a taxpayer's 180-day deadline for investing in a QOF falls between April 1, 2020, and December 31, 2020, the Notice provides that the new deadline to make the QOF investment is December 31, 2020. Earlier this year, the IRS issued Notice 2020-23, which in part provided some relief to taxpayers wanting to invest in QOFs but faced some delays in making their investment due to COVID-19. That notice provided that if a taxpayer's 180-day deadline for investing in a QOF falls between April 1, 2020, and July 15, 2020, the deadline for investing was automatically extended to July 15, 2020.

Ninety-Percent Standard for QOFs

To qualify as a QOF, at least 90% of the QOF's assets must consist of qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held by that QOF as measured (i) on the last day of the first 6-month period of the taxable year of the QOF, and (ii) on the last day of the taxable year of the QOF. If the QOF does not meet this standard, the QOF is liable for a penalty for each month; it does not meet the 90% test unless the failure is due to reasonable cause.

The Notice provides that if either of the testing dates falls between April 1, 2020, and December 31, 2020, and the QOF fails to meet the 90% on those dates, then the QOF's failure is due to reasonable cause and the QOF will not lose its qualification as a QOF and it will not be liable for a penalty.

Substantial Improvement Requirements

For a property to qualify as qualified opportunity zone property, the property's original use in a qualified opportunity zone must begin with the QOF, or the QOF must substantially improve the property. A QOF significantly improves property if, during the 30 months following the QOF's acquisition of the property, the QOF makes "additions to the basis with respect to such property" that exceed the QOF's adjusted basis in the property at the start of the 30 months. The Notice states that the 30 month period for substantially improving a property is tolled from April 1, 2020, through December 31, 2020.

Working Capital Safe Harbor

Qualified opportunity zone businesses

must have less than 5% of its assets in nonqualified financial property. Reasonable amounts of cash and cash equivalents held as working capital do not count as nonqualified financial property. The opportunity zone regulations provide a working capital safe harbor if certain requirements are met. One requirement is that there is a written schedule consistent with the ordinary start-up of a trade or business for spending the working capital assets within 31 months.

If the business is located in a qualified opportunity zone within a Federally declared disaster, the business may receive not more than an additional 24 months to expend its working capital assets, as long as the qualified opportunity zone business otherwise meets the requirements of the working capital safe harbor. The Notice states that because of the COVID-19 pandemic, companies that would otherwise qualify for the working capital safe harbor may receive up to an additional 24 months to deploy working capital.

Twelve Month Reinvestment Period

If a QOF disposes of qualified property or receives a distribution as a return of its capital investment in a qualified opportunity zone business and the QOF reinvests those proceeds in a qualified opportunity within 12 months, those proceeds are treated as qualified zone property for purposes of the 90% standard (discussed above). If the QOF's plan to reinvest the proceeds is delayed because of a Federally declared disaster, the QOF may receive up to an additional 12 months to reinvest the proceeds, provided that the QOF invests the proceeds in the manner originally intended before the disaster. The Notice provides that the because of the COVID-19 pandemic, if the QOF's reinvestment period includes January 20, 2020, the QOF may have an additional 12 months to reinvest proceeds in other qualified opportunity zone property in the manner originally intended before January 20, 2020.