

IRS Provides Relief for Certain Opportunity Zone Requirements in Light of COVID-19 Pandemic

On June 4, 2020, the Internal Revenue Service (IRS) issued Notice 2020-39 (the IRS Notice), which provided investors, qualified opportunity funds (QOFs) and qualified opportunity zone businesses (QOZBs) with additional time to meet certain requirements under Section 1400Z-2 of the Internal Revenue Code, as amended (the Code), and the Treasury Regulations promulgated thereunder because of the economic uncertainty created by the ongoing COVID-19 pandemic.

The relief provided by the IRS Notice is summarized as follows:

Investors:

180-Day Investment Period (*Extended*) – Under Code Section 1400Z-2, a taxpayer can defer recognizing (and, in some cases, permanently exclude from gross income a portion of) certain types of realized gains, if they invest the amount of their gain into a QOF within a 180-day period. The IRS Notice gives taxpayers whose 180-day investment period ends on or after April 1, 2020, and before Dec. 31, 2020, until Dec. 31, 2020, to timely invest their eligible gain into a QOF.

QOFs:

90 Percent Test (*Relief*) – Under Code Section 1400Z-2, a QOF must hold at least 90 percent of its assets in qualified opportunity zone property (QOZP) on an annual basis. Whether a QOF meets this test is determined by averaging the percentage of QOZP held by the QOF on the last day of the first six-month period of the QOF's taxable year and on the last day of the QOF's taxable year (each of those two

measuring days, a Measuring Date). If a QOF fails to meet the 90 percent test in a taxable year, it will be subject to a penalty, unless such failure is due to a reasonable cause. The IRS Notice states that if a QOF's Measuring Date falls within the period beginning on April 1, 2020, and ending on Dec. 31, 2020, any failure by the QOF to meet the 90 percent test for the year that includes that Measuring Date shall be deemed to be due to reasonable cause, thereby eliminating any penalty. Such failure also will be disregarded when determining whether the QOF or its investors satisfy any other requirement of Section 1400Z-2 of the Code.

Reinvestment Period (*Extended*) – Under Code Section 1400Z-2, if a QOF receives proceeds from the sale or disposition of QOZP, or a return of capital, and the QOF reinvests some or all of those proceeds in QOZP by the last day of the 12-month period beginning on the date of receipt, the reinvested proceeds are treated as QOZP for purposes of the 90 percent test if, prior to the reinvestment, the proceeds were continuously held in cash, cash equivalents or certain short-term debt instruments. Final Treasury Regulations provide that the 12-month reinvestment period may be extended an additional 12 months in the case of a federally declared disaster. Per the IRS Notice, if a QOF's original 12-month reinvestment period included Jan. 20, 2020 (i.e., the date identified by the President's disaster declaration under the Stafford Act for all 50 states), such QOF has an additional 12 months to reinvest proceeds received from a distribution, sale or disposition in accordance with Treasury Regulation § 1.1400Z2(f)-1(b)(2).

QOZBs:

Working Capital Safe Harbor (*Extended*) – Under Code Section 1400Z-2, less than 5 percent of the average of the aggregate unadjusted bases of a QOZB's property may be attributable to nonqualified financial property (NQFP) on an annual basis. NQFP does not include reasonable amounts of working capital held in cash, cash equivalents or certain short-

term debt instruments. Under the final Treasury Regulations, working capital assets will be treated as reasonable in amount if certain requirements are satisfied (collectively, the Working Capital Safe Harbor), which requirements include an obligation for the QOZB to consume those working capital assets within 31 months of receipt. That 31-month period may be extended 24 months, however, if the QOZB is located in a federally declared disaster area. Applying its extension authority under that final Treasury Regulation in the event of a disaster, the IRS Notice provides that any QOZB that is utilizing the Working Capital Safe Harbor before Dec. 31, 2020, has an additional 24 months to consume its identified working capital assets under the Working Capital Safe Harbor.

QOFs/QOZBs:

Substantial Improvement Period (Tolled) – Under Code Section 1400Z-2, both QOFs and QOZBs have to hold a certain amount of their assets in qualifying property. One type of qualifying property is qualified opportunity zone business

property (QOZBP). To qualify as QOZBP, such property has to either meet what is referred to as the “original use” test or be “substantially improved.” In order to be considered substantially improved, additions to basis with respect to the property during a 30-month period must exceed the adjusted basis of the QOF or QOZB, as applicable, in that property at the beginning of that 30-month period. The IRS Notice provides that the period beginning on April 1, 2020, and ending on Dec. 31, 2020, is disregarded when determining whether a taxpayer meets the 30-month substantial improvement time frame (i.e., the substantial improvement period is tolled during that period). In other words, the IRS Notice effectively extends all 30-month periods which include all of April 1 – Dec. 31, 2020, by nine months (or for the number of months during that time frame that originally were in the taxpayer’s 30-month period).

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