

QUALIFIED OPPORTUNITY ZONE DEADLINES

On June 4, 2020, the IRS issued Notice 2020-39, which announced various extensions of deadlines for qualified opportunity funds (“QOF”s) and their investors in response to the COVID-19 pandemic. The following is a brief description of that relief.

180-Day Investment Period for QOF Investors

Investors generally have 180 days from the date they recognize a taxable gain to invest that gain in a QOF and defer recognition of such gain. In response to the economic slowdown caused by the COVID-19 pandemic, the IRS issued an earlier notice that gave investors whose 180-day deadline was set to expire between April 1 and July 15 until July 15, 2020 to invest that gain. Pursuant to Notice 2020-39, the IRS now allows investors whose 180-day deadline was to expire between April 1 and December 31 until December 31, 2020 to invest in QOFs. The relief is automatic. Investors will not be required to request relief from the IRS or document any such requests.

90 Percent Investment Standard for QOFs

Prior to issuance of Notice 2020-39, if a QOF failed to hold at least 90 percent of its assets in qualified opportunity zone (“QOZ”) property (as determined by the average of the percentage of QOZ property held on certain semi-annual testing dates), it would have been subject to a penalty for each month it failed to meet this 90 percent standard. Notice 2020-39 provides that if the close of a QOF’s taxable year falls within the period beginning April 1, 2020, and ending December 31, 2020, or if a QOF’s initial semi-annual testing date falls during that April 1-December 31, 2020 period, any failure to meet the 90 percent investment standard for the taxable year will be disregarded for purposes of determining whether a penalty will be imposed. Such failure will not prevent qualification of an entity as a QOF or an investment in a QOF from being a qualifying investment.

Working Capital Safe Harbor for QOZ Businesses

An entity must meet certain requirements to be deemed a QOZ business, including a requirement that less than five percent (by adjusted basis) of its property is financial property (other than reasonable amounts of working capital held in cash, cash equivalents or debt instruments). The regulations provide that an amount of working capital is reasonable for purposes of this five percent test, if the following “safe harbor” requirements are met: (i) such amounts are designated in writing for the acquisition, construction, and/or substantial improvement of tangible property in a QOZ; (ii) there is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of working capital assets under which they must be spent within 31 months of receipt; and (iii) the working capital assets actually are used in a manner that is substantially consistent with clauses (i) and (ii). Notice 2020-19 provides that working capital assets intended to be covered by the working capital safe harbor before December 31, 2020 have an additional 24 months within which to be expended, for a total of 61 months.

30-Month Substantial Improvement Period for QOFs and QOZ Businesses

To be deemed a QOZ business, at least 70 percent of an entity’s tangible property must be qualified QOZ tangible property. To be deemed tangible property, the original use of such property must commence in the opportunity zone or must “substantially improve” the property in the property zone. For this purpose, tangible property consisting of land and building will be treated as substantially improved if, during any 30-month period beginning after the date of acquisition of such property additions to the basis of the building exceed an amount equal to the basis of the building at the beginning of such 30-month period. Notice 2020-39 provides that the 30-month period during which property held by a QOF or QOZ business must be substantially improved is tolled during the period beginning on April 1, 2020 and ending on December 31, 2020.

12-Month Reinvestment Period for QOFs

IRS regulations provide generally that, if (i) a QOF sells or disposes of some or all of its QOZ property or if a distribution with respect to the QOF’s QOZ stock is treated as a return of capital in the QOF’s hands, and (ii) the QOF reinvests some or all of the proceeds in QOZ property by the last day of the 12-month period beginning on the date of the distribution, sale, or disposition, then to the extent proceeds are so reinvested, they are treated as QOZ property for purpose of the 90 percent investment standard. This treatment is available to a QOF only to the extent that, prior to the reinvestment in QOZ property, the reinvested proceeds are continually held in cash, cash equivalents, or debt instruments with a term of 18 months or less. Notice 2020-39 reminds QOFs and their investors that the Covid-19 pandemic was identified as a federally declared disaster on January 20, 2020, and if that date falls within the 2-month period during which a QOF must reinvest proceeds, the QOZ is entitled to an additional 12 months to reinvest, provided it invests in the manner originally intended before the January 20 date.

If you are engaged in a QOZ business or need assistance in structuring one, please contact Barry Klingman at baklingman@wbny.com or 212-984-7727.