

2021 COVID-19 Timing Relief for QOFs, QOZBs, and Opportunity Zone Investors

A Practical Guidance® Article by Jessica Millett, Duval & Stachenfeld LLP



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On January 19, 2021, the IRS issued [Notice 2021-10](#), which extends relief previously granted last June to those in the opportunity zone investors in response to the COVID-19 pandemic. The earlier relief was contained in [Notice 2020-39](#) (the June 2020 Notice), but many of its provisions expired on December 31, 2020. Given the ongoing pandemic, Treasury and the IRS received numerous requests for additional relief. The Opportunity Zone program (the OZ Program) is riddled with deadlines and time-sensitive requirements, so the further relaxation and extension of some of these deadlines and requirements is welcome news. Although the IRS did not include any new areas of hoped-for relief, discussed below in the Missed Opportunities section, the extension of the relief provisions from the June 2020 Notice will be helpful for investors, qualified opportunity funds (QOFs), and qualified opportunity zone businesses (QOZBs).

For additional background and guidance on opportunity zones, see [A Clearer Path to Opportunity Zones, Existing Owners of Property in an Opportunity Zone – Right Place, Right Time?](#), [How Does COVID-19 Impact Opportunity Zones?](#), and [COVID-19 Timing Relief for QOFs, QOZBs and Opportunity Zone Investors](#).

Deadline for Investing Eligible Gains

To get the full suite of OZ Program tax benefits, a taxpayer must generally invest eligible gain into a QOF within the 180-day period beginning on the date on which the 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).

June 2020 Notice

[Notice 2020-39](#) stated that if a taxpayer’s 180-Day Investment Period ended on or after April 1, 2020, and before December 31, 2020, the taxpayer had until December 31, 2020, to invest eligible gain into a QOF.

New Guidance and Its Impact

[Notice 2021-10](#) states that if a taxpayer’s 180-Day Investment Period ends on or after April 1, 2020, and before March 31, 2021, the taxpayer now has until March 31, 2021, to invest eligible gain into a QOF.

This extension is certainly helpful for potential investors, but it would have been even more helpful to have had this extension in place before December 31, 2020, when the relief provided by the June 2020 Notice expired. Many

investors rushed to get their QOF investments made by December 31, 2020, so this new guidance is really only helpful to investors who (1) missed the prior deadline at the end of 2020 or (2) have a 180-Day Investment Period that expires in the first quarter of 2021 since they now have a bit more time. Any procrastinators with 2019 K-1 gains get one more bite at the apple.

Note that 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. At this point, any investors deferring 2019 gain will need to make the election in an amended return.

90% Asset Test for QOFs

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.

June 2020 Notice

If either of the QOF Testing Dates fell 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 was automatically deemed to be due to reasonable cause, so there would be no penalty imposed on the QOF.

New Guidance and Its Impact

The new Notice extends this relief to testing dates that fall in the first half of 2021. Now, for any QOF Testing Dates that fall within the period beginning on April 1, 2020, and ending on June 30, 2021, 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 extension will be a relief to QOFs and fund managers, given the continued uncertainty in the market. Many QOFs that had planned to invest in qualifying property in 2020, especially in the spring and summer, were forced to delay, reschedule, or abandon closings altogether. This blanket

reasonable cause relief gives most QOFs until the December 2021 testing date before they have to worry about the 90% asset test.

Note that any QOFs claiming this relief for 2020 are still required to timely file Form 8996, and they must accurately complete all lines on that form, including the 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.

Extension of 30-Month Substantial Improvement Period

If a QOF or a QOZB acquires existing property, the property will only be qualifying tangible property to the QOF or 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 QOF or 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.)

June 2020 Notice

The period beginning on April 1, 2020, and ending on December 31, 2020, would be disregarded for purposes of meeting the Substantial Improvement Test. Any property that was in the midst of its 30-month substantial improvement period on April 1, 2020, therefore had a 39-month substantial improvement period.

New Guidance and Its Impact

The new Notice extends the end of the disregarded period from December 2020 to March 31, 2021. Now, the period beginning on April 1, 2020, and ending on March 31, 2021, will be disregarded for purposes of meeting the Substantial Improvement Test. Any property that was in the midst of its 30-month substantial improvement period on April 1, 2020, now has a 42-month substantial improvement period. Any new improvement periods that begin before April 1, 2021, have a few extra months before the 30-month clock begins.

Although construction has continued in certain markets during the pandemic, some 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.

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 an additional 24 months in the event of a federal disaster.

June 2020 Notice

The IRS confirmed that the Emergency Declaration in March 2020 triggered the federal disaster provisions in the Treasury Regulations and that all QOZBs with working capital assets intended to be covered by a WCSH before December 31, 2020, were eligible to receive not more than an additional 24 months to spend the working capital.

New Guidance and Its Impact

The new Notice extends this relief from December 31, 2020, to June 30, 2021. Thus, all QOZBs with working capital assets intended to be covered by a WCSH before June 30, 2021, will receive not more than an additional 24 months to spend the working capital, for a maximum safe harbor period of not more than 55 months total (and not more than 86 months total for start-up businesses).

One issue that remains uncertain is whether all QOZBs automatically receive a full additional 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 (1) when you had to shut down your office; (2) when various government offices where you submitted applications were closed; (3) when you got notice that your architect, contractor, or consultant had to close their offices or stop working; and (4) 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.

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 taking those amounts into account 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.

June 2020 Notice

Since the Emergency Declaration in March 2020 triggered the federal disaster provisions in the Treasury Regulations, a QOF with a 12-month reinvestment period that included January 20, 2020, had an additional 12 months to reinvest proceeds from either a sale of property or the return of capital, provided that the QOF invested those proceeds in the manner originally intended before January 20, 2020.

New Guidance and Its Impact

The new Notice extends this relief to reinvestment periods that include June 30, 2020. Now, a QOF with a 12-month reinvestment period that includes June 30, 2020, has an additional 12 months, for a maximum reinvestment period of 24 months total, to reinvest proceeds from either a sale of property or the return of capital, provided that the QOF invests those proceeds in the manner originally intended before June 30, 2020.

Missed Opportunities

Many OZ stakeholders had hoped the next round of COVID-19 relief would address additional issues. A few glaring omissions include a QOZB's 50% gross income test and a QOZB's ability to change its WCSH plan.

50% Gross Income Test

The 50% gross income test requires that 50% of a QOZB's gross income be derived from the active conduct of a trade or business in an opportunity zone. This requirement is more critical for operating business QOZBs than real estate QOZBs, since real estate QOZBs generally generate their income from real estate in an opportunity zone, which tends not to move. For operating business QOZBs, the Treasury Regulations offer a number of safe harbors, several of which rely on the location of employees and independent contractors performing services for the QOZB. If the services are performed in an opportunity zone, a QOZB may be able to rely on a safe harbor to meet the gross income test. However, many employees and other service providers are working remotely during the pandemic. Many hoped the IRS would offer guidance on how to apply the location-based safe harbors during the pandemic, perhaps by treating services performed by employees while working remotely as if they had been performed in an opportunity zone, or by otherwise waiving the requirement for 2020 and 2021. In the absence of guidance on this point, QOZBs should ensure they can meet the 50% gross income test, either by meeting one of the location-based safe harbors or generally as a result of the facts and circumstances test.

Working Capital Safe Harbor Plan

A QOZB has a 5% limit on nonqualified financial property, but a QOZB can hold a reasonable amount of working capital. If a QOZB properly documents and maintains a WCSH, its working capital assets are treated as reasonable in amount, and any financial property (such as cash) that is covered by the WCSH loses its otherwise disqualifying taint.

First, the WCSH must contain a statement in writing that the QOZB's working capital assets are designated for the development of a trade or business in an opportunity zone, including, if appropriate, the acquisition, construction, and/or substantial improvement of tangible property in an opportunity zone (the Statement).

Second, the WCSH must contain a written schedule for the planned expenditure of the working capital assets within 31 months of the receipt by the QOZB of the working capital assets.

Third, the QOZB must actually use the working capital assets in a manner that is substantially consistent with the Statement and the 31-month schedule. With the COVID-19 pandemic, there may be projects which no longer make sense. For example, developing a new hotel in a dense urban area may not be the best use of a QOZB's investment dollars.

Unfortunately, the Treasury Regulations are silent on the process, and the consequences, of a change in a QOZB's

plans. The Treasury Regulations do not provide any explicit mechanism for a QOZB to change its Statement, and there is a risk that a QOZB could fall out of the WCSH if either its Statement changes or if its working capital assets are ultimately used in a manner that is inconsistent with its initial Statement. Although there is no explicit guidance on whether a QOZB can change its Statement and 31-month schedule, it seems reasonable that this would be permitted as long as there is a reasonable commercial justification for the change. If one of the policy goals of the OZ Program is to encourage economic activity in opportunity zones, it makes sense to permit QOZBs to pivot as needed to develop projects that will help to achieve that goal. Recordkeeping will again be helpful here, so make sure that any changes to a QOZB's Statement and 31-month schedule are documented with an explanation about why the change is happening. Any evidence showing external factors out of the QOZB's control should help to justify the changes.

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Jessica Millett is co-chair of Duval & Stachenfeld's Tax Practice Group. She has particular expertise in U.S. tax issues that arise in complex real estate transactions, notably Qualified Opportunity Fund structures. She regularly advises clients on tax structuring and documentation for QOF investments, real estate acquisitions, joint ventures, restructurings and refinancing arrangements, including inbound and outbound investments, and structures involving REITs.

Most recently, Ms. Millett has been at the forefront of structuring investments into Opportunity Zones. To date, she has been quoted in Bloomberg, Real Estate Weekly, The Commercial Observer, and The Wall Street Journal and she has made numerous presentations to industry groups. Ms. Millett was also named as one of the Top 50 People Shaping the Future of Opportunity Zones by *Opportunity Zone Magazine*.

Ms. Millett ensures that tax advice is an integral part of the deal from the very beginning. She is able to translate complex tax concepts into simple and straightforward issues, and clients appreciate that she is business savvy and understands the industry as well as the current market.

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