Opportunity Zone Rule Changes Due to COVID-19

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In response to the ongoing COVID-19 pandemic, the Internal Revenue Service ("**IRS**") recently issued IRS Notice 2020-39, which provides certain relief related to the calculation of time-sensitive deadlines under the federal Opportunity Zone program ("**OZ Program**") outlined in Internal Revenue Code ("Code") Section 1400Z-2 and the underlying Treasury Regulations ("**OZ Regulations**"). Although the IRS previously extended the 180-day deadline to invest in a qualified opportunity fund (in addition to other tax related deadlines) under IRS Notice 2020-23, IRS Notice 2020-39 expands upon the prior relief and provides investors and existing projects additional time to address issues and delays related to the COVID-19 pandemic.

Overview of Opportunity Zone Relief Provided Under IRS Notice 2020-39

- **180-Day Investment Requirement for Investors in a Qualified Opportunity Fund ("QOF")**
  - **General 180-Day Investment Requirement.** Code Section 1400Z-2 and the OZ Regulations generally require a taxpayer to invest eligible gain into a QOF within 180 days from the day the taxpayer would recognize the gain for federal tax purposes in order receive the available tax incentives (*i.e.*, temporary deferral of gain, basis step-up, exclusion of appreciation). As a result, if a taxpayer generates eligible gain from the sale of stock that the taxpayer owns individually, the 180-day period would start on the date the stock is sold.
  - **180-Day Investment Requirement for Owners of a Passthrough Entity.** With respect to an owner's distributive share of eligible gain from a partnership/passthrough entity that the

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partnership/entity did not elect to defer by investing in a QOF on behalf of the partnership/entity, the owner of a passthrough entity has the following three options for when the 180-day investment period begins for the partner's share of the eligible gain:

- **End of the Entity's Taxable Year.** The 180-day period begins on the last day of the passthrough entity's taxable year (which for most entities taxed as a partnership would be 12/31). This is the general rule absent an election for a separate start date by the owner.
- **Date the Passthrough Entity Recognizes the Gain.** The owner can elect to use the passthrough entity's 180-day start date instead of the end of the entity's taxable year. For example, if the passthrough entity generated gain from the sale of stock on April 10, 2019, and the entity determined it was not going to elect to defer the gain by investing in a QOF, the partner could elect to invest its share of eligible gain in a QOF within the 180-day period beginning on April 10, 2019 rather than wait until December 31, 2019 for the 180-day period to begin.
- **Date the Passthrough Entity's Tax Return is Due .** The owner can elect to use the due date of the passthrough entity's tax return, without extensions, for the tax year in which the eligible gain was generated, as the start date for the 180-day period. For entities taxed as a partnership, that date is generally March 15 of the following year.

- **IRS Notice 2020-39 Relief – What Changes?**
Extending a previous extended deadline under IRS Notice 2020-23 (extending certain time-sensitive deadlines falling on or after April 1, 2020 to July 15, 2020), IRS Notice 2020-39 provides that if the 180-Day period to make a qualifying investment into a QOF

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(depending on how the investor elected to calculate that 180-Day period) would have ended on or after April 1, 2020, and before December 31, 2020, then such taxpayers are automatically provided an extension until December 31, 2020.

- **Next Steps – Duty to Make a Timely Deferral Election.** Despite the automatic relief, the taxpayer will still need to make a valid deferral election on IRS Form 8949 and complete IRS Form 8997 and file these forms with a timely filed federal tax return (including any extension) or amended federal tax return for the taxable year in which the gain would have otherwise been recognized.

- **90% Investment Standard for QOFs**
  - **90% Investment Standard Summary.** At least 90% of the assets owned by a QOF must be Qualified Opportunity Zone Property (*e.g.*, an equity interest in a Qualified Opportunity Zone Business and/or Opportunity Zone Business Property) ("**QOZ Property**"). The QOF calculates the 90% investment standard semi-annually: (i) on the last day of the first six-month period of the taxable year; and (ii) on the last day of the taxable year. The two semi-annual test results are then averaged to determine whether the QOF satisfies the 90% threshold, and the results are reported by the QOF on IRS Form 8996. Absent reasonable cause, the QOF is subject to civil penalties if the QOF fails the 90% investment standard. This requirement is the source of the often misrepresented requirement that a QOF has 180 days to invest in QOZ Property. The QOF simply has to invest in a timely manner to satisfy the semi-annual tests, keeping in mind the fact that the QOF has the option to not take into account any investments into the QOF that occurred within the six month period prior to the semi-annual test when calculating the numerator and denominator for such test.

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- **IRS Notice 2020-39 Relief – What Changes?** IRS Notice 2020-39 provides that for QOFs whose semi-annual test dates – (i) last day of the first six-month period of the taxable year or (ii) last day of the taxable year – fall within the period beginning on April 1, 2020, and ending on December 31, 2020, any failure by that QOF to satisfy the 90% investment standard for that taxable year of the QOF is (a) due to reasonable cause under Code Section 1400Z-2(f)(3); and (b) disregarded for purposes of determining whether the QOF or any otherwise qualifying investments in that QOF satisfy the requirements of Code Section 1400Z-2 and the OZ Regulations for any taxable year of the QOF. As a result, if the QOF fails the 90% investment standard for the tax year due to failing to meet the standard at one or more of its semi-annual test dates occurring during the relief period under Notice 2020-39, the QOF will not be subject to civil penalties.
- **Next Steps – Duty to Complete and File Form 8996.** The 90% investment standard relief is automatic under IRS Notice 2020-39; however, despite the automatic relief, a QOF must accurately complete and timely file IRS Form 8996 (except that the penalty line may remain at zero) with its federal tax return for the affected taxable years.

- **30-Month Substantial Improvement Period for QOFs and Qualified Opportunity Zone Businesses ("QOZBs")**
  - **30-Month Substantial Improvement Period Summary**. One of the requirements for tangible property to qualify as Qualified Opportunity Zone Business Property ("**QOZB Property**") is that if the original use of the tangible property in the zone does not begin with the QOF or QOZB that purchased the property, the QOF or QOZB must substantially improve the property (*i.e.*, generally, the cost of improvements exceed the purchase price) within 30 months from the date the

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QOF or QOZB purchases the property. This requirement is critically important because QOZB Property is qualifying property for purposes of a QOF's 90% investment standard and at least 70% of the tangible property owned or leased by a QOZB must be QOZB Property. If a QOF or QOZB fails to satisfy the 30-month substantial improvement requirement with respect to any tangible property it purchases, such failure could potentially impact the qualifying status of the QOF or QOZB and, as a result, possibly subject a QOF investor to civil penalties and/or limit a QOF investor's ability to claim certain tax incentives under the OZ Program.

- **IRS Notice 2020-39 Relief – What Changes?** The 30-month substantial improvement period is automatically tolled for the period beginning April 1, 2020 through December 31, 2020, which means that no portion of this time period will be included in calculating the 30-month substantial improvement period for any tangible property. The 30-month "clock" is effectively stopped until December 31, 2020. If a QOF or QOZB's 30-month period was set to expire on or after April 1, 2020, the expiration date is extended through December 31, 2020. This relief does not limit or preclude other relief that may be available to a QOF or QOZB under Code Section 1400Z-2 or the OZ Regulations related to the 30-month substantial improvement period.

- **Working Capital Safe Harbor for QOZBs**
  - **Working Capital Safe Harbor Summary.** The OZ Regulations provide QOZBs with a safe harbor for treating an amount of working capital assets as reasonable (if certain requirements are met) for the purpose of satisfying the limitation on the amount of non-qualified financial property a QOZB can hold ("Working Capital Safe Harbor"). Generally, such working capital assets will fall within the Working Capital Safe

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Harbor as long as the QOZB has a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets within 31 months of the QOZB's receipt of the assets. A QOZB may extend the Working Capital Safe Harbor period up to a maximum aggregate period of 62 months if certain additional requirements are met.

- **IRS Notice 2020-39 Relief – What Changes?** IRS Notice 2020-39 provides that all QOZBs holding working capital assets intended to be covered by the Working Capital Safe Harbor before December 31, 2020 shall automatically receive up to an additional 24 months to expend the working capital assets of the QOZB, as long as the QOZB otherwise meets the requirements for the Working Capital Safe Harbor.

- **12-Month Reinvestment Period for QOFs**
  - **12-Month Reinvestment Period Summary.** The OZ Regulations generally provide that if a QOF sells or disposes of some or all of its QOZ Property or if a distribution with respect to the QOF's qualified opportunity zone stock is treated as a return of capital in the QOF's hands, the QOF has 12 months beginning on the date of the distribution, sale, or disposition to reinvest such proceeds in QOZ Property for the proceeds to be treated as QOZ Property for purposes of the QOF's 90% investment standard.
  - **IRS Notice 2020-39 Relief – What Changes?** IRS Notice 2020-39 provides if a QOF's 12-month reinvestment period includes January 20, 2020, then that QOF automatically receives up to an additional 12 months to reinvest in QOZ property some or all of the proceeds received by the QOF from the return of capital or the sale or disposition of some or all of the QOF's QOZ Property, provided that the QOF satisfies the requirements under the QOZ Regulations and invests the proceeds in the manner originally intended

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before January 20, 2020.

Frost Brown Todd counsels clients across the country on ways to work through issues and problem-solve when it comes to these important deadlines and other COVID-19 related issues. We will remain at the forefront of all major developments from the IRS and Congress impacting the OZ Program, and we are ready to assist clients in connection with their Opportunity Zone projects. For more information, please contact Chris Coffman, Brad Butler, Amy Curry, Emily Meyer, Kevin Cooney, Colleen Haas, Gray Sasser, Alex Derkson, or Marty Mooney.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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