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IRS Notice 2020-39 Provides Significant COVID-19 Relief to Qualified Opportunity Zone Projects and Investors

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In response to the ongoing COVID 19 pandemic, the IRS has given investors an extension of time to invest in Qualified Opportunity Zone projects, and has given Qualified Opportunity Funds (“QOFs”) and Qualified Opportunity Zone Businesses (“QOZBs”) additional time to satisfy certain statutory requirements. These extensions are described in IRS Notice 2020-39 (the “Notice”), released on June 5.

Extension of time for investors to make Opportunity Zone investments

An investor who recognizes a capital gain normally has 180 days to make a qualifying investment in a QOF. Under the Notice, if the last day of the 180-day period would have fallen on a date between April 1 and December 30, 2020, the last day of the 180-day period is extended to December 31, 2020. Prior pandemic relief only granted an extension to July 15, 2020.

This means that investors who recognized capital gains on assets held directly after October 4, 2019, or recognized capital gains through ownership of an interest in a pass-through entity (such as a partnership or S corporation) with a tax year ending December 31, 2019, generally will have until December 31, 2020 to invest in a QOF.

Extension of working capital safe harbor

The Qualified Opportunity Zone regulations provide a “working capital safe harbor” that permits a QOZB to hold working capital for up to 31 months without violating the limit on the amount of nonqualified financial property held by the QOZB. This working capital safe harbor makes it possible for a QOZB to hold cash reserves to fund business start-up expenses or to fund the acquisition, development or improvement of “qualified opportunity zone business property” (“QOZ Business Property”).

The Notice confirms that as a result of the federal COVID-19 disaster declaration, any QOZB that holds working capital assets prior to December 31, 2020, which assets are intended to be covered by the working capital safe harbor, receives an automatic 24-month extension of the 31-month safe harbor as to those working capital assets.

For example, if cash was contributed to a QOZB in January 2020 and the safe harbor requirements were satisfied, the end of the safe harbor period has been extended from July 2022 to July 2024.

Recent amendments to the Opportunity Zone regulations provide that a QOZB that holds cash under the working capital safe harbor generally will be deemed to satisfy the requirement that 70 percent of the tangible assets of a QOZB consist of QOZ Business Property, regardless of its actual asset ownership at the time. Thus, the new 24-month extension of the working capital safe harbor will significantly help QOZBs satisfy the 70 percent test.

OPPORTUNITY ZONES AND QUALIFIED OPPORTUNITY FUNDS

Extension of 30-month substantial improvement period

If a QOF or QOZB purchases a used asset, it generally must substantially improve the asset (i.e. spend at least as much to improve the asset as it did to acquire the asset) within a 30-month period in order for that asset to be treated as QOZ Business Property. The Notice provides that the period beginning on April 1, 2020, and ending on December 31, 2020, will be disregarded for purposes of determining the 30-month substantial improvement period.

For example, if a QOZB acquired a previously used building on January 1, 2020, and began making improvements on that date, the time to make substantial improvements to the building has been extended by nine months, from June 30, 2022, to March 31, 2023. The extension will be shorter, however, for property purchased after April 1, 2020.

Relief from QOF 90 percent investment test

At least 90 percent of the assets of a QOF must consist of investments in a QOZB or QOZ Business Property held directly by the QOF. Compliance with this 90 percent investment test is measured on the last day of the first six-month period of each taxable year of the QOF and on the last day of each taxable year of the QOF. The Notice treats any failure of a QOF to satisfy the 90 percent investment test for any date falling between April 1, 2020, and December 31, 2020, as due to reasonable cause and disregarded for purposes of determining whether the QOF or its investments satisfy the Qualified Opportunity Zone rules. This means that a QOF with a calendar taxable year will not need to satisfy the 90 percent investment test until June 30, 2021.

Extension of QOF reinvestment period

For purposes of satisfying the 90 percent investment test, a QOF that sells some or all of its qualified opportunity zone property has 12 months following the original sale to reinvest the sale proceeds in replacement qualified opportunity zone property. (Any gain on the sale remains fully taxable to the QOF or its investors, but the investors could defer gain by making a new investment in a QOF.)

Under the Notice, a QOF which sold property prior to January 20, 2020, and whose 12-month reinvestment period included January 20, 2020, will have an additional 12 months to reinvest the sale proceeds. The reinvestment must be made in the same manner as originally intended before January 20, 2020. This is an extremely limited benefit, and does not apply to any sales occurring after January 20, 2020.

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