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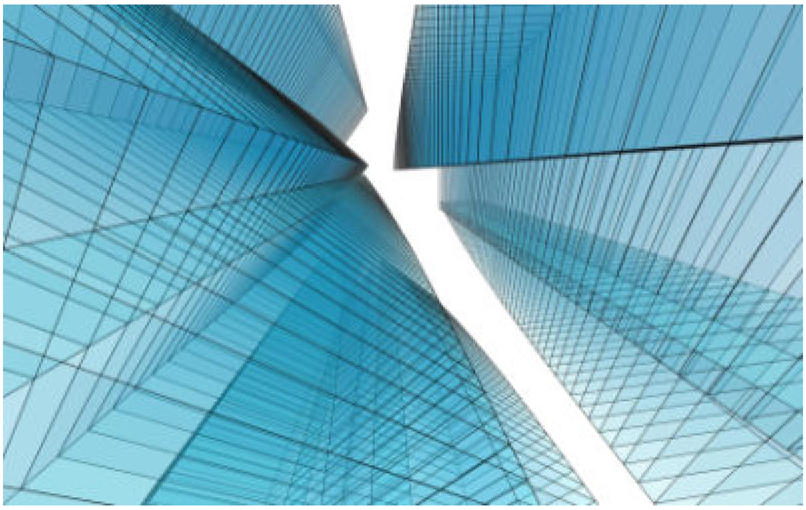

TAX | IRS Grants Tax Relief for Qualified Opportunity Funds and Investors in Response to the COVID-19 Pandemic

In Notice 2020-39, released on June 4, 2020, (the “Notice”), the US Internal Revenue Service (the “IRS”) extended certain deadlines for investing in qualified opportunity funds (“QOFs”) and relaxed certain investment requirements. These changes are intended to make it easier for QOFs and investors to manage QOF investments in light of the ongoing coronavirus disease 2019 (“COVID-19”) pandemic.

As discussed in more detail below, under the relief provided by the Notice: (i) if a taxpayer’s 180-day period to invest capital gains in a QOF ends on or after April 1, 2020, the taxpayer will have until the end of 2020 to make an investment in a QOF; (ii) failures by a QOF to satisfy the 90-percent test (discussed below) on any semi-annual testing dates that fall between April 1, 2020, and December 31, 2020, will be excused; (iii) the IRS has confirmed that certain extensions available in connection with a federally declared disaster will apply to the COVID-19 pandemic (“Disaster Declarations”)[1]; and (iv) the 30-month period to substantially improve qualified opportunity zone property will be tolled from April 1, 2020, until the end of this year.

Extension of the 180-Day Period for QOF Investors

Generally, pursuant to the QOF rules, investors who wish to defer capital gains have 180 days from the applicable recognition date to invest such capital gains into a QOF.[2]

In Notice 2020-23, the IRS had previously granted an extension of time to make certain investments in a QOF.[3] The Notice extends this relief and provides that if a taxpayer’s 180th day to invest in a QOF would fall on or after April 1, 2020, and before December 31, 2020, the taxpayer now has until December 31, 2020, to invest such gain into a QOF. While this relief is automatic, a taxpayer must still make a valid deferral election in accordance with IRS Form 8949, *Sales and Other Dispositions of*

Capital Assets; complete IRS Form 8997, *Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments*; and file such forms with a timely filed federal income tax return (including extensions) or amended federal income tax return, if applicable.

Penalty Waived for Failure to Satisfy the 90-Percent Test

In order to qualify as a QOF, an entity must hold at least 90 percent of its assets in qualified opportunity zone property tested on a semi-annual basis (the "90-percent test").[4] If the QOF fails to meet the 90-percent test, the QOF must pay a penalty for each month that the QOF fails to meet that test.[5] However, no penalty will be imposed if the taxpayer shows that such failure is due to reasonable cause.[6]

The Notice provides that a QOF's failure to satisfy the 90-percent test on any semi-annual testing dates that fall between April 1, 2020, and December 31, 2020, is deemed to be due to "reasonable cause" and such failure does not prevent qualification of an entity as a QOF or an investment in a QOF from being a qualifying investment. Accordingly, the QOF will not be liable for the statutory penalty due to such a failure. This relief is automatic, but a QOF is still required to file IRS Form 8996, *Qualified Opportunity Fund*, with respect to each affected taxable year.

24-Month Extension of Working Capital Safe Harbor

A qualified opportunity zone business cannot have 5 percent or more of its assets in "nonqualified financial property."[7] For this reason, the amounts held as working capital are not treated as nonqualified financial property if such working capital is deployed within 31 months pursuant to a written schedule and certain other requirements are met (the "working capital safe harbor").[8] If a qualified opportunity zone is designated as a federally declared disaster area, the related qualified opportunity zone business may be eligible to extend the time period to deploy its working capital beyond 31 months for an additional 24 months as long as the qualified opportunity zone business otherwise satisfies the working capital safe harbor.[9]

The Notice confirms that *all* qualified opportunity zones are designated as federally declared disaster areas pursuant to the Disaster Declarations, and, therefore, qualified opportunity zone business projects that otherwise satisfy the requirements of the working capital safe harbor now have an additional 24 months to deploy their working capital on top of the existing 31-month period.

12-Month Extension of the Reinvestment Period

The QOF rules generally provide that proceeds received by a QOF from the sale or disposition of qualified opportunity zone business property are treated as qualified opportunity zone property for purposes of the 90-percent test so long as the QOF reinvests such proceeds in qualified opportunity zone property within a year.[10] In the case of a federally declared disaster, the QOF rules further provide that a QOF may have an additional 12 months to reinvest such proceeds provided that the QOF reinvests the proceeds in the manner originally intended before the disaster.[11]

The Notice confirms that if a QOF's 12-month reinvestment period includes January 20, 2020, such QOF will now have an additional 12 months to reinvest such proceeds in qualified opportunity zone property without having any impact on the 90-percent test provided that the QOF reinvests the proceeds in the original intended manner.

Tolling of the 30-Month Substantial Improvement Period

Under the QOF rules, tangible property is treated as qualified opportunity zone business property if the tangible property is used in a trade or business of the QOF and, among other requirements, the QOF substantially improves that property.[12] Tangible property is treated as substantially improved only if a taxpayer doubles its adjusted tax basis in the property during any 30-month period beginning after acquisition of such property.[13] For example, if a QOF acquires used tangible property in a qualified opportunity zone, the QOF has 30 months from the date of acquisition to substantially improve such property in order for it to be treated as qualified opportunity zone business property.[14]

Pursuant to the Notice, with respect to property held by a QOF or qualified opportunity zone business, the 30-month substantial improvement period is tolled during the period beginning on April 1, 2020, and ending on December 31, 2020.

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If you wish to receive regular updates on the range of the complex issues confronting businesses in the face of the novel coronavirus, please subscribe to our COVID-19 "Special Interest" mailing list.

And for any legal questions related to this pandemic, please contact the authors of this Legal Update or Mayer Brown's COVID-19 Core Response Team at FW-SIG-COVID-19-Core-Response-Team@mayerbrown.com.

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[1] On March 13, 2020, President Trump declared the ongoing COVID-19 pandemic a national emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the "Stafford Act"). Following this emergency declaration, the president issued major disaster declarations under the authority of the Stafford Act with respect to all 50 states, the District of Colombia and five territories. These major disaster declarations provided that, beginning on January 20, 2020, major disasters existed in each of these jurisdictions, within which is located every population census tract designated as a qualified opportunity zone under Section 1400Z-1 of the Internal Revenue Code of 1986, as amended (the "Code"). *See* Notice 2018-48, 2018-28 I.R.B. 9 (Nov. 21, 2018); Notice 2019-42, 2019-29 I.R.B. 352 (Oct. 10, 2019) (which collectively list every designated qualified opportunity zone).

[2] Code § 1400Z-2(a)(1)(A).

[3] On April 9, 2020, the Department of the Treasury and the IRS issued Notice 2020-23, which postponed the 180th day through July 15, 2020, for certain taxpayers affected by the COVID-19 pandemic. *See generally* Notice 2020-23, Part III (April 9, 2020) (providing relief for certain time-sensitive actions due to be performed on or after April 1, 2020, and before July 15, 2020).

[4] Code § 1400Z-2(d)(1).

[5] Code § 1400Z-2(f)(1).

[6] Code § 1400Z-2(f)(3).

[7] Nonqualified financial property includes debt, stocks, partnership interests and various other financial instruments. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(iv).

[8] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(B).

[9] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D).

[10] Treas. Reg. § 1.1400Z2(f)-1(b)(1).

[11] Treas. Reg. § 1400Z-2(f)-1(b)(2).

[12] Code § 1400Z-2(d)(2)(D)(i)(II)-(III).

[13] Code § 1400Z-2(d)(2)(D)(ii); Treas. Reg. § 1.1400Z2(d)-2(b)(4)(i).

[14] Treas. Reg. § 1.1400Z2(d)-2(b)(4(ii).