

CLIENT ALERT

Opportunity Zones

April 20, 2021

Introduction

A federal law passed in December 2017, usually referred to as the “Tax Cuts and Jobs Act” (though that is not its technical name) added a section entitled “Opportunity Zones” as Subchapter Z, Internal Revenue Code (the “Code”), Section 1400Z-1 and 1400Z-2 (herein, that new Subchapter will be referred to as the “OZ Act”). The OZ Act introduced an investment mechanism designed to incentivize long-term capital investment to provide equity to fund developments of businesses and properties located in certain designated low-income communities throughout the US and its territories. The mechanism relied on attractive tax benefits and incentives made available to US taxpayers.

The core of the new investment mechanism is easily summarized. Taxpayers who recognize capital gain from a sale of property to an unrelated party can invest some or all of the gain (generally within 180 days) in a new legal entity – a “Qualified Opportunity Fund” (“QOF”), and, provided the QOF complies with rules applicable to it, taxpayers with capital gain invested in a QOF can enjoy three specific tax benefits:

- a) Deferral of the capital gain tax otherwise due on the initial sale of property;
- b) A reduction in the amount of capital gain tax paid when the deferral ends, keyed to holding the QOF interest for specific periods of time (10% reduction for a five-year hold and an additional 5% reduction if the QOF interest were held for at least seven years, although due to the timing requirements of the statute, the additional 5% reduction is no longer available);
- c) Elimination of any capital gains tax otherwise due on the accumulated appreciation of the QOF interest if a sale of the appreciated QOF interest occurs after a ten-year hold.

The deferred tax on original gain becomes due if the taxpayer sells its QOF interest before December 31, 2026 or, if no such sale has occurred by then (and assuming the absence of any other “inclusion event”) on December 31, 2026. The exclusion of tax on appreciated gain can be enjoyed after a ten-year hold. There is no

forced sale of QOF interests or property held by the QOF, but if no sale of the QOF interests or property held by the QOF has occurred by December 31, 2047, then there is a mandated step-up in basis.

An investor can access the tax benefits offered by the OZ Act by using eligible gain to

- Purchase an interest in a QOF directly from the QOF (in a transaction that can be designed like a private placement); or
- Purchase an interest in a QOF held by a third party (in a transaction that can be designed like a purchase and sale of equity interests between two parties).

Initial Impact of the OZ Act

While it would be months following the passage of the OZ Act before the details of the program received guidance from the U.S. Treasury Department (“Treasury”), some initial conclusions were obvious:

- anyone with, or able to generate, eligible capital gain could get involved. For example, a taxpayer with large accumulated gains in the stock market or owning appreciated real estate who previously had forgone the urge to sell because of the tax bite could now sell assets, re-invest sales proceeds in a QOF, and defer the immediate capital gain tax on the sale. If the QOF interests (or the property held by the QOF) appreciate in value over time, the taxpayer might be able to execute a later sale tax-free;
- businesses already within the geographically designated Qualified Opportunity Zones (“QOZs”) and looking to raise capital had a new potential source of funds; and
- businesses with cash on hand and expansion plans had new enticements to make investments in geographic areas and, potentially, product lines that had not received much attention from the investing community.

Equally apparent were the restrictions imposed by the OZ Act that make investing in QOZs uniquely challenging:

- investors are required to hold the QOF Interests for at least 10 years to receive the tax elimination benefit – hence, the program is for the long-term investors;
- the QOF must invest in businesses or properties connected to or located in one of the designated QOZs; and
- testing dates and other compliance requirements (and any consequences for noncompliance) were unclear.

Noticeably absent in the OZ Act (pre-guidance/regulations) were two critical components of any successful program initiative: (a) measurement tools to ascertain whether the program was working as designed, and (b) clear “out of bounds” stakes, laying out what conduct was acceptable and what conduct was not.

To be sure, there was optimism and interest in the OZ program, but the naysayers also had a field day, criticizing

- the original QOZ designation process;

- the fact that QOF investors had to start with capital gains (thereby excluding the majority of the US population) and then could receive even more tax breaks (“the rich get richer”);
- the loss of the revenue that otherwise would have flowed to the Treasury absent the tax deferral, reduction, and possible elimination of tax altogether;
- the lack of required reporting by investors or funds, from which the public could measure the effects of the program (was money flowing to the underserved communities?);
- the use of census tracts to create the QOZs was based on 2010 census data, which was clearly outdated by 2017. Many low-income census tracts as of 2010 had become developed, gentrified, and were relatively affluent by the time the OZ Act was passed, and these locations needed no help to generate investment interest; and
- a prevailing view that most of the early Opportunity Zones projects would have been built anyway, leading a conclusion that the program didn’t create any new developments but rather just made “already in the works” projects more attractive.

Initially, the attention around the OZ Act was focused was on:

- technical questions – what types of gains were eligible, what types of entities can be QOFs, what structures work for ownership, how do test dates work for the 90% asset test, etc.;
- how can a business located in a QOZ satisfy the requirement that at least 50% or more of its gross income must be derived from “the active conduct of a trade or business” within QOZs;
- are “feeder funds” eligible to participate (e.g., could syndicators of tax credits raise opportunity funds from their investors and then invest in other QOFs);
- how the various “time” and “use” requirements work (because fundamental to the OZ Act is that (a) the original investment in a QOF needs to be made in a certain time period, (b) the original investment needs to be deployed by the QOF within certain time periods, and (c) the funds deployed by the QOF must be spent on certain qualifying assets and the associated income must be tracked by location.

Understanding the OZ Act

Understanding the OZ Act requires (a) parsing through a number of definitions, terms and phrases, some new and some old (or at least familiar to those conversant with the Code), (b) mastering the technical details of numerical tests, standards of performance and/or ownership of property assets, (c) understanding the contours of locations of the QOZs, and (d) awareness of the “out of bounds” stakes (relating to “sin businesses,” anti-abuse regulations and the inclusion/exclusion events that reflect normal ranges of life activities like gifts, bequests, etc.).

Also, understanding the OZ Act requires familiarity with a number of OZ Act-related definitions and concepts, including::

- Eligible gain – only capital gain is eligible for the tax benefits provided by the OZ Act. By virtue of the Final Regulations, both long-term and short-term capital gain is eligible. In addition, gross Section 1231 gain is eligible without a “netting” of Section 1231 losses.
- Entities eligible to be a QOF – any entity classified as a corporation or partnership for U.S. Federal Income tax purposes and created or organized in a U.S. state, the District of Columbia, or a U.S. possession. Multi-member LLCs are eligible, too, but single-member LLCs treated as a disregarded entity are not.
- Taxpayer. Literally, any US taxpayer who recognizes capital gain following a sale can be a QOF investor. Partnerships and other pass-through entities qualify.
- Qualified opportunity zone (“QOZ”)
- Qualified opportunity fund (“QOF”)
- Qualified opportunity zone business (“QOZB”)
- Qualified opportunity zone business property (“QOZBP”)
- Qualified opportunity zone stock
- Qualified opportunity zone partnership interest
- Related party
- Original use
- Substantially all
- Substantial improvement
- Working capital safe harbor
- Income derived from the active conduct of a trade or business within the QOZ
- Nonqualified financial property

Add to the litany of “what do these words and phrases mean” the myriad of more technical and focused questions, like

- Do leases of property qualify in the OZone world?
- Where there is a test and/or a test period, how is it calculated?
- What kinds of costs/uses of QOF monies are okay and which ones are not?
- What happens when the taxpayer’s plans are adversely affected by circumstances beyond the taxpayer’s reasonable control (i.e. the “force majeure” events commonplace in commercial contracts)?

- How are future sales treated? What happens when sales of interests or property occur sooner than the 10-year holding period? And what about multi-asset QOF partnerships – can the QOF sell some (but not all) of its assets and retain tax benefits?
- How do “exits” and future sales work? Is the sale of one’s interest in the QOF what was needed or is the sale of the property held by the QOF sufficient? What would happen in circumstances where sales occurred earlier than the ten-year hold? What would happen if a partnership that is a QOF sold some of its assets after ten years?
- What are the consequences of noncompliance? Is the penalty financial only, or might the entire QOF investment be declared ineligible for the tax benefits which were the very *raison d’être* for the investment in the first place?

It would be left to guidance – Proposed Regulations Round One and Two and, ultimately, the Final Regulations – to answer many of the above.]

What is a Qualified Opportunity Zone?

A U.S. census tract (using 2010 census data) that is a “low income community,” defined as a low-income census tract, selected and designated by a state’s governor from the tracts that are eligible for designation. Designations occurred in 2018 and were subsequently certified by the Internal Revenue Service (the “IRS”). There are over 8,700 QOZs throughout the U.S. and its territories. Interestingly, the IRS showed great deference to the governors in the designation process; all tracts designated by the governors were certified by the IRS.

What is a Qualified Opportunity Fund?

A private sector investment vehicle, organized as a partnership or corporation, formed for the purpose of investing in “qualified opportunity zone property” (but specifically not another QOF) that must hold at least 90% of its tangible property assets in Qualified Opportunity Zone Property (“QOZP”) (generally referred to as the “90% Test”).

A QOF can hold and deploy an unlimited amount of eligible gain; there is no minimum amount of taxpayer gain required nor maximum which cannot be exceeded.

Owing principally to the satisfaction of the asset rules, most successful QOFs have been organized as “single purpose” entities, established for the single purpose to invest in a single asset. Although a QOF can operate a business itself, it is most common for a QOF to operate a business through a Qualified Opportunity Zone Business (“QOZB”) subsidiary. This structure provides flexibility and makes it easier for a QOF to meet the statutory requirement that 90% of its funds be invested in Qualified Opportunity Zone Property (the “90% Test”).

What is a Qualified Opportunity Zone Business?

An entity in which “substantially all” of the tangible property owned or leased by the entity is Qualified Opportunity Zone Business Property (“QOZBP”), where “substantially all” means 70% (the “70% Test”).

Also, certain sections of the Code (namely, paragraphs (2), (4), and (8) of Section 1397(C)(b)) impose requirements that imported into the definition of QOZB, including that the QOZB:

- must derive at least 50% of its gross income from active conduct of a business within a QOZ (the “50% Gross Income Test”);
- cannot hold more than 5% of its assets (in excess of reasonable working capital) in non-qualified financial property (“NQFP”);
- cannot operate one of the defined “sin” businesses, including gambling facilities, racetracks, stores the principal business of which is the sale of alcoholic beverages for consumption on premises, private or commercial golf courses, country clubs, massage parlors, and hot tub and suntan facilities.

QOZBs are connected to a site-specific QOZ through a series of tests that require, among other things:

- “substantially all” of the tangible property held by the QOZB must be QOZBP (acquired or leased for use in one or more QOZs);
- more than 50% of the gross income of the QOZB must be derived from the active conduct of a trade or business within one or more QOZs;
- a “substantial” proportion (generally, at least 40%) of a QOZB’s intangible property must be used in one or more QOZs;
- not more than 5% of the assets held by the QOZB can be NQFP. Because NQFP is limited to 5% (in excess of reasonable working capital) for a QOZB, it would be difficult for a QOZB to hold equity in another entity.

What is Qualified Opportunity Zone Property?

QOZP is the QOF’s ownership interests in a corporation or partnership or the qualifying tangible property owned or leased by the QOF and used by the QOF in a business within a specific QOZ. Qualified Opportunity Zone Property includes:

- Qualified Opportunity Zone Stock (i.e., stock in a corporation that qualifies as a QOZB);
- Qualified Opportunity Zone Partnership Interests (i.e., partnership interests in a partnership that qualifies as a QOZB); or
- QOZBP.

For Qualified Opportunity Zone Stock and Qualified Opportunity Zone Partnership Interests, (a) the stock or partnership interests (as applicable) must be acquired by the QOF after December 31, 2017 (i.e., after the OZ Act was enacted), (b) the corporation or partnership must either be a QOZB or have been formed to be a QOZB, and (c) for “substantially all” of the holding period of the stock or partnership interests, the corporation or partnership, as applicable, qualified as a QOZB.

What is Qualified Opportunity Zone Business Property?

Qualified Opportunity Zone Business Property includes tangible property used in a trade or business if:

- such property was acquired by the QOF by purchase after December 31, 2017;
- the “original use” of the property in the QOZ started with the QOF or the QOF “substantially improved” the property; and
- during substantially all of the holding period, substantially all of the use of the property was in a QOZ.

What is “original use”?

In April 2019, Treasury provided guidance for defining “original use” with respect to QOZBP. For tangible property acquired by purchase, “original use” commences when the property is “placed in service” for depreciation purposes, creating a workable and well-established standard.

In addition, vacant and abandoned land can qualify as “original use” property. Treasury’s Final Regulations established that land that is vacant or abandoned can qualify as “original use” property if it satisfies the vacancy rule, which, according to the Final Regulations, is one year if the property was vacant as of the date the QOZ was designated and three years if the vacancy arose after the QOZ designation.

Importantly, leased property does not need to satisfy the “original use” requirement.

Finally, “Brownfields” sites are automatically “original use” property (meaning no “substantial improvement” test is required, as long as investments are made by the QOF or the QOZB within a reasonable time to improve safety and compliance with environmental regulations).

What is “substantial improvement”?

In determining whether real property has been “substantially improved” to qualify as QOZBP, the QOF/QOZB must expend on improvements at least one dollar more than the purchase price allocated to the building/improvements component of the real property acquisition (Treasury provided that the purchase price allocated to the land is not taken into account in satisfying the “substantial improvement” requirement). Operationally, a QOF/QOZB can (reasonably) allocate a purchase price for real property among land and building components and then expend on the building component an amount equal to the allocated building valuation plus \$1.00, thereby satisfying the “substantial improvement” test.

The “substantial improvement” test may be done on an aggregate basis in some circumstances, allowing the consolidation of contiguous properties.

What is a “related party”?

There are a number of Code rules concerning “related parties.” For Opportunity Zones, sales which generate eligible gain must be from an unrelated party. Treasury decided that a “related party” is one with at least 20% of common ownership. Interestingly, leases between related parties are allowable, subject to some reasonable guidelines.

Early Investing

Investments into newly formed QOF entities started in 2018, almost as soon as the Opportunity Zones were designated. Early investors recognized that, as originally drafted, the potential for 15% reduction in capital gain

tax paid on the invested gain required investment into a QOF by December 31, 2019, as the 7-year hold and the date to pay the deferred tax were interrelated.

Meanwhile, lawyers and tax advisors tried to guide investors and businesses through the rules, asking Treasury to make clear how quickly money (a) had to go into a QOF and (b) had to be spent by a QOF. Participants took their time searching for the best locations and the best business models, a process entirely at odds with the fundamental goal of accelerating economic growth in the Opportunity Zones.

It was easy to understand why there wasn't more of a "full speed ahead" approach. First, the rules are exacting. Second, and more important, to benefit from the "holy grail" of no tax on appreciation after the ten-year hold, there has to be appreciation. In other words, the asset must increase in value. Hence, like many things in life, "picking the winners" is paramount – a combination of the right business in a location that works.

Regulations Clarify the OZ Act

The evolution of Opportunity Zones from December 2017 through December 2019 is proof-positive that the "devil is in the details." The OZ Act, which added Opportunity Zones into the Code, totaled fewer than 2,000 words, but that was before stakeholders weighed in.

As with most tax legislation and programs, implementation would require guidelines from Treasury and the IRS; the world of Opportunity Zones was no exception. Two sets of interim Proposed Regulations were followed by Notices and Revenue Rulings and then, at the end of December 2019, Final Regulations (which themselves totaled over 500 pages of text, guidance and examples). What started as relatively simple and straightforward became quite complicated.

Initial Guidance and Proposed Resolutions

Treasury released its first set of Proposed Regulations in October 2018. Industry reaction was generally thankful for the guidance given, complimentary of the results as far as they went, and then somewhat critical of what was not done. The more time spent in the weeds, analyzing potential structures, and assessing the landscape through the prism of usual commercial business activities, the more there were demands of Treasury and the IRS to issue additional guidance and explanation.

The "easy" ambiguities were addressed in the first set of Proposed Regulations, which reflected a philosophy of being investor-friendly and accommodating rather than rigid. The clear mission of Treasury and the IRS was to make the Opportunity Zones program work and accelerate the flow of money into QOZs. Principal among the initial clarifications (and still applicable today) are:

- taxpayers eligible to participate in the Opportunity Zones program can be individuals or partnerships and other types of pass-through entities, like S-corporations and their shareholders. Mechanically, a partnership with gain must make an election respecting a qualified investment into a QOF, but, if the partnership fails (or elects not) to make a qualified investment with its eligible gain, then any individual partner may make the election for him/her/itself.
- A partnership that has a gain recognition event can make a qualified investment into a QOF within 180 days after the gain recognition event, and, if the partnership fails (or elects not to) make a qualified investment with its eligible gain, each partner has a 180-day period (beginning at the end of the tax year

in which the partnership's option to make a qualified investment has expired) in which make a qualified investment for him/her/itself. The Final Regulations provide an additional alternative for partners in which the 180-day period begins on the unextended due date of the partnership return. Only capital gains (not ordinary gains) are eligible for deferral.

- A QOF must be an entity classified as a corporation or partnership (including a multi-member limited liability company) for U.S. federal income tax purposes and created or organized within one of 50 states, the District of Columbia or a U.S. possession territory.
- An entity can become a QOF by a self-certification, satisfied by the filing of Form 8896 with the entity's first tax return.
- Taxpayers use a Form 8949 to report the deferral of capital gains tax as a result of an investment in a QOF.
- "Substantially all" means different things in different contexts. In order to be a QOZB, "substantially all" of a business' property must be QOZBP; Treasury decided that "substantially all" in this context is 70%.

Just as important as the definitional clarity was the initial guidance explaining how certain aspects of the Opportunity Zones program work:

- The investment in a QOF must be in exchange for an equity interest in the QOF.
- "Special allocations" (providing specifics of profit/loss distributions not identical to percentage ownership in the QOF) are allowed.
- The creation of a "working capital safe harbor" that provides a mechanism by which eligible gains invested in a QOF can be held without resulting in the non-compliance with the 90% Test. The "working capital safe harbor" has become a fundamental operational tenet of how the Opportunity Zones program works. For QOFs that utilize a QOF-QOZB structure to hold assets, the QOZB can hold invested cash as working capital for up to 31 months, subject to certain tolling provisions and the following three requirements:

(1) there must be a written plan detailing how, within the 31-month period following the contribution of the invested cash to the QOZB, the invested cash will be spent (and the cash must be spent consistent with the 70% Test);

(2) the plan must be reasonable and entered into contemporaneously with the cash being contributed from the QOF to the QOZB; and

(3) the plan must be substantially followed.

The details of the working capital safe harbor have been refined through multiple rounds of guidance from Treasury, including permitting working capital to be held for "development" uses and permitting a 62-month plan for start-up businesses. In addition, by virtue of overlapping or sequential applications of the working capital safe harbor, even ordinary businesses could receive up to 62 months to use its capital provided there are multiple infusions of non-de minimis amounts of cash and the later infusions of cash form an integral part of the written plan established by the first safe harbor.

- The use of debt by a QOF is allowed and does not compromise the tax-free exclusion or appreciation provided the QOF interest is held for the required 10 years. In fact, debt is a necessary component of most QOF structures due to the special basis rules for QOFs.
- Leases are not only allowable – they are treated favorably. Provided the lease (including any lease between “related parties”) is on “market” terms was entered into after December 31, 2017, leased property can be QOZBP if “substantially all” of the use of the property occurs in the QOZ for “substantially all” of the lease period. Moreover, the guidance sets forth a methodology for calculating the value of leases.

There is no original use requirement attached to lease property, and all leases are presumed to be on “market” terms. That presumption, however, is rebuttable, enabling Treasury to catch the “outliers.”

- Triple net leases, however, receive slightly different treatment. According to Treasury, “merely entering into a triple net lease with respect to real property owned by a taxpayer is not the active conduct of a trade or business.” In fact, triple net leases remain in the gray area, neither clearly “out of bounds” nor fully allowed, and Treasury has essentially establishing a “facts and circumstance” determination. Consequently, QOFs/QOZBs must be wary when attempting to qualify a triple net lease as a “good” asset for testing purposes.

What was clear from the initial guidance issued in the fall of 2018 was that those operating reasonably within existing language were not going to be disadvantaged or penalized if the rules subsequently changed. The message to investors was obvious – Treasury was trying to think through technical issues, it would take time and those who were already doing what the OZ Act promoted (investing in QOZs) were not going to be made scapegoats.

Subsequent Guidance and Proposed Resolutions

The second round of guidance, issued in April of 2019, provided clarity and/or specificity in areas where previously ambiguity existed. In addition, the second round of guidance facilitated investments by widening the range of allowable activity.

By the time the second set of proposed regulations was issued, most practitioners in the OZ regime had settled on two core structures for QOFs:

- a two-tier structure in which taxpayer investors hold interests in a QOF which itself operates the trade or business (with 90% of the QOF’s assets being tangible property); or
- three tiers in which the gain investors hold interests in a QOF, the QOF invests in a QOZB, and the QOZB operates a trade or business within a QOZ.

The specifics contained in the April 2019 guidance addressed a host of questions: Ultimately, as a general warning, Treasury cautioned:

“if a significant purpose of a transaction is to achieve a tax result that is inconsistent with the purposes of Section 1400Z-2, the Commissioner can recast a transaction (or a series of transactions) for federal tax purposes as appropriate to achieve tax results that are consistent with the purposes of section

1400Z-2. Whether a tax result is consistent with the purposes of Section 1400Z-2 must be determined based on all the facts and circumstances.”

Final Regulations

In December 2019, a full two years after OZ Act came into existence, Treasury and the IRS released the Final Regulations, to be effective March 13, 2020 (a date which later became noted as the day a national emergency was declared in the infancy of the COVID-19 pandemic).

In the main, the Final Regulations confirm many of the tests and many of the thresholds previously outlined in the first two sets of proposed regulations. In addition, Treasury clarified what the industry considered open issues/concerns and answered some (not all) of the lingering questions. As stated in the issuance, the Final Regulations were designed to make the “rules easier to follow and understand.” In doing so, none of the benefits of previous guidance favorable to investors were taken away. Taxpayers who had stayed within the issued guidelines did not find themselves and/or their investments “out of bounds.” In fact, some previously announced restrictive rules were relaxed or even overturned.

Among the major substantive points elaborated upon in the Final Regulations was the gnarly question of from where a QOZB derived its income. The Final Regulations established three “safe harbor” tests for a QOZB to satisfy the 50% Gross Income Test and clarified that a QOZB need comply with only one of the safe harbor tests to remain in compliance:

- at least 50% of the hours worked by employees and/or independent contractors performing services are with one or more QOZs;
- at least 50% of the compensation paid to employees and independent contractors is for services performed with one or more QOZs; and
- at least 50% of the gross income generated was from the combination of tangible property in one or more QOZs and the management functions performed by the business in one or more QOZs.

If a QOZB cannot clearly fit into one of the three 50% Gross Income Test safe harbors, Treasury also permits a catch-all “facts and circumstances” test.

The Final Regulations included other helpful clarifications, including:

- Section 1231 gains, which can be used by a taxpayer as eligible gain for investments into QOFs, do not have to be “netted” against the taxpayer’s Section 1231 losses;
- permitting property in the process of being “substantially improved” to qualify as “good” QOZBP for purposes of satisfying the 90% Test and the 70% Test;
- all gain on the sale of a QOF interest or underlying assets after 10 years, other than gain from a sale of inventory in the ordinary course of business, is excluded from taxation;
- leases from governmental entities do not need to be on “market terms,” an enhancement to encourage further investments in QOF communities; and

- expanding the anti-abuse statement included in the Proposed Regulations by clarifying the “purposes of Section 1400Z-2,” which Treasury stated as:

The purposes of section 1400Z-2 and the section 1400Z-2 regulations are to provide specified Federal income tax benefits to owners of QOFs to encourage the making of longer-term investments, through QOFs and qualified opportunity zone businesses, of new capital in one or more qualified opportunity zones and to increase the economic growth of such qualified opportunity zones.

The Final Regulations also described several circumstances considered to be “inclusion events” upon which a QOF investor can lose some or all of the tax benefits of the investment and also lose the deferral of the payment of tax originally invested in the QOF. Significant points clarified include:

- debt-financed distributions to investors in a QOF are not an “inclusion” event, to the extent of an investor’s basis in the QOF; however, investors must be cognizant of the disguised sale rules and generally cannot take distributions within two years of investment in a QOF;
- an investment received as a beneficiary by reason of death (i.e. an inheritance) remains a qualified investment in the hands of the beneficiary (who becomes liable for the deferred tax when due);
- gifts, however, are “inclusion” events (and the tax is owed by the donor);
- a transfer of interests pursuant to a divorce is also an “inclusion” event, with the tax on deferred gain due at the time of the event and the QOF interest no longer eligible for the other tax benefits;

The Final Regulations also confirmed that a QOF has 12 months to re-invest sale proceeds derived from the sale of property without losing Opportunity Zones tax benefits.

Effects of the COVID-19 Pandemic

The ink was barely dry on the Final Regulations when COVID-19 entered our collective lives, and its impact required Treasury to revise and adjust deadlines and tests.

Three times since the World Health Organization declared the COVID-19 outbreak a pandemic, Treasury issued Notices (Notices 2020-23, 2020-39, and 2021-10) that granted extension relief to taxpayers. While some of the relief was not specifically connecting the granted relief to the Opportunity Zones program, the general taxpayer relief as applied to the nascent program was both needed and welcomed.

Notice 2020-23 extended the time for filings and payments due between April 1, 2020 and July 14, 2020 to July 15, 2020. Our Client Alert appended a chart that documents which returns and payments were subject to the deadline relief. The relief granted under Notice 2020-23 was automatic.

The extension relief granted under Notice 2020-23 went further and listed a number of other time-sensitive actions that received automatic extensions, and extension relief was granted to the IRS for it to take certain requisite actions involving, among other things, audits and appeals.

At about the same time, and seemingly unrelated to COVID-19 pandemic-induced relief, Treasury issued two additional Opportunity Zones regulations. First, Treasury extended the 31-month “working capital safe harbor” by up to 24 months for any property in a federal declared disaster area. Second, Treasury allowed a QOF an

additional 12 months to re-invest sale proceeds derived from the sale of property without losing Opportunity Zones tax benefits.

On June 4, 2020, the Service issued Notice 2020-39. Generally, extra time was afforded for certain actions and grace was afforded to those who failed to satisfy the 90% Test for acceptable reasons. Notice 2020-39 granted specific relief from five time-sensitive actions required under the OZ Act:

- with respect to the 180-day requirement to invest in a QOF following a sale of property that generated eligible gain, if the deadline to make such investment fell between April 1 and December 31, 2020, then the extended deadline became December 31, 2020, subject to the taxpayer making a valid deferral election and filing completed tax returns in a timely fashion;
- in a similar fashion, if one of the test dates for satisfying the 90% Test fell between April 1 and December 31, 2020, then the failure to meet the standard would be automatically excused as due to “reasonable cause,” subject to the taxpayer completing and filing, in timely fashion, the required federal tax return forms;
- the 30-month “substantial improvement” test for property to qualify as QOZBP was accorded a 9-month tolling hiatus (i.e., the months of April-December, 2020, were disregarded in the 30-month count);
- any declaration of a national emergency, including the federal government’s declaration of a national emergency in response to the COVID-19 pandemic, met the “federally declared disaster” predicate of an early 24-month extension to the 31-month working capital safe harbor; hence, the 31-month period became a 55-month period; and

the deemed satisfaction of the “federal disaster standard,” together with the text of the Final Regulations, resulted in an extra 12 months to reinvest proceeds derived from a sale of QOZBP. As circumstances evolved, what appeared to be reasonable extensions in 2020 proved not to be enough, as many aspects of life in the United States, indeed the world, were continually and negatively impacted by the effects of the COVID-19 pandemic. Hence, the IRS issued Notice 2021-10, which extended further relief, including:

- the 180-day period to invest (after eligible gain was realized) was extended to March 31, 2021;
- the “substantial improvement” requirement was also accorded relief by virtue of disregarding the period from April 1, 2020 through March 31, 2021 in calculating the 30 months to complete the substantial improvement. As with Notice 2020-39, this relief is automatic, provided the taxpayer files the proper forms.

* * *

Sullivan’s [Opportunity Zones Group](#) has a multi-disciplinary team consisting of lawyers from our Tax, Real Estate, Affordable Housing and Corporate practice groups. We work closely with clients across the country to analyze how they might implement this legislation into their business strategy. We speak and publish often on the program's latest developments.

If you have any questions or would like to discuss Opportunity Zones, please feel free to contact any of the Sullivan lawyers listed below:

Benjamin Armour
617 338 2423
barmour@sullivanlaw.com

John Gahan
617 338 2472
jgahan@sullivanlaw.com

Daniel Ryan
617 338 2457
dryan@sullivanlaw.com