IRS Releases Generous Guidance for QOZs During Coronavirus Pandemic

On June 4, the IRS released Notice 2020-39, containing five items of relief for Qualified Opportunity Funds during the coronavirus pandemic.

Extension of time for investors to make qualifying investments into Funds. In normal times, investors have 180 days to make such investments (generally measured from the sale of an asset triggering capital gain; sometimes measured from a later date, e.g. receipt of a K-1). Previously, in Notice 2020-23, the IRS extended this deadline until July 15, 2020, in cases where the last day of this 180-day window fell between April 1, 2020 and July 15, 2020.

New Notice 2020-39 extends this extension, by replacing July 15, 2020 with December 31, 2020. This relief is automatic. If investors expect asset prices to fall by December 31, they should take full advantage of this extension and delay their investment.

Waiver of the 90% investment standard for 2020. Every year, along with their tax returns, QO Funds must file Form 8996. On this form, they summarize the contents of their balance sheet on two testing dates during the prior year. If less than 90% of assets consist of “QOZ Property,” the Fund incurs penalties for the year.

New Notice 2020-39 effectively waives this requirement for 2020. That is: when Form 8996 is filed in 2021 as to tax year 2020, any failure to satisfy the 90% investment standard is automatically deemed due to reasonable cause. The Fund must still complete Form 8996 accurately, but if the investment standard is failed, the QOF should place a “0” in Part IV, Line 8 (Penalty). This means that a Fund can (for example) sit on a balance sheet of cash for the duration of 2020, while waiting for asset prices to fall.

Tolling of 30-month substantial improvement period. Generally, for real property rehabilitations, the original property must be “substantially improved” (i.e., its adjusted basis must be doubled) within any 30-month period.

New Notice 2020-39 provides that taxpayers may treat as a valid 30-month period, the 39-month interval between April 1, 2020 and June 30, 2023. This means that if a Fund does decide to begin construction during 2020, it will not be penalized if the construction is interrupted, as long as it meets the substantial improvement test within this extended 39-month period.

24-month working capital safe harbor. Under normal circumstances, operating subsidiaries of QO Funds have 31 months to consume their working capital assets. However, if the QOZ is in a disaster area, the regulations specify that the 31-month safe harbor may be extended by “up to” 24 months.

New Notice 2020-39 clarifies that: (i) the phrase “up to” will not be interpreted to mean fewer than 24 months; (ii) this relief is automatic; and (iii) this relief is available for subsidiaries which hold working capital assets before December 31, 2020 which they intend to be covered by the safe harbor.

12-month reinvestment period. Likewise, operating subsidiaries normally have 12 months to reinvest returns of capital. Within disaster areas, this 12-month reinvestment period may be extended by 12 months.

New Notice 2020-39 clarifies that this extension applies to any QOF whose 12-month reinvestment period includes January 20, 2020.