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Qualified opportunity zone projects have ‘up to’ 24 more months due to COVID-19



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On March 13, President Donald Trump declared the COVID-19 outbreak to be a nationwide emergency. This declaration has important consequences for qualified opportunity funds and their subsidiaries. In general, qualified opportunity zone businesses have 31 months to expend their working capital. Thanks to the president’s emergency declaration, qualified opportunity zone businesses in all 50 states should now be entitled to “up to” 24 additional months.

To ensure that qualified opportunity zone businesses serve their communities, there are limits on how much cash they can hold. In general, the amount of cash or similar assets on the business’s balance sheet cannot exceed 5% of total assets, plus “reasonable amounts of working capital.” Most businesses rely on a regulatory safe harbor, under which “reasonable” working capital includes any amounts which (i) are projected to be spent over the next 31 months towards buying, building, or improving tangible property, and (ii) are actually spent in a manner “substantially consistent” with that plan. For example, if the qualified opportunity zone business received the working capital assets at the end of 12/2019, then it must have a plan for spending these amounts by the end of 07/2022, and it must execute the plan accordingly. For many qualified opportunity zone businesses, this 31-month window is the most pressing time constraint.

Coronavirus has thrown these plans out the window. Workers are unavailable. Government offices are closed. Inspectors cannot appear on site. Parts cannot be ordered from abroad. Developers may also want to slow down for economic reasons, to take advantage of an expected decline in construction costs or a hoped-for resurgence in rents.

For these businesses, the final regulations published in January contain relief. Treas. Reg. Section 1.1400Z2(d)-1 (d)(3)(v)(D) states that “If the qualified opportunity zone business is located in a qualified opportunity zone within a federally declared disaster (as defined in Section 165(i)(5)(A)), the qualified opportunity zone business may receive up to an additional 24 months to consume its working capital assets,” as long as it meets all other requirements.

The president’s emergency declaration should meet this test, because it describes a “federally declared disaster.” As defined in Section 165(i)(5)(A), this term means “any disaster subsequently determined by the president of the United States to warrant assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.” (The regulation probably ought to have referred to qualified opportunity zones within a “disaster area,” defined in section 165(i)(5)(B) to mean “the area so determined to warrant such assistance.”) Strictly speaking, the President declared an “emergency,” not a “disaster.” Under the Stafford Act, the terms have different meanings. See 42 U.S.C. 5122. However, for tax purposes, they mean the same thing. See Rev. Rul. 2003-29 (“For purposes of Section 165(i), a disaster includes an event declared a major disaster or an emergency under the Act.”)

All qualified opportunity zone businesses, everywhere in the United States, should be eligible for the extension. This is because the president’s letter declares an emergency “nationwide.” Support for this interpretation appears on the FEMA website, at <https://www.fema.gov/disasters>, which lists all declared disasters and emergencies. On this website, there is a COVID declaration for every state. For example, the declaration for California has the caption “California Covid-19 (EM-3428),” and the event is identified as “disaster 3428.” The incident is described as commencing on Jan. 20, and the emergency declaration occurred on March 13. Within this entry, the “designated areas” for disaster 3428 are listed. This is simply a list of all the counties in California. Thus, all projects within a California qualified opportunity zone should be eligible for the extension.

Readers are cautioned not rely on our interpretation until Treasury issues guidance on the topic, which we hope will happen soon. The qualified opportunity zone final regulations are only two months old, and a nationwide emergency appears to be unprecedented. Treasury should also cast light on the meaning of “up to” in the phrase “up to an additional 24 months.” Any guidance on these topics will probably be accompanied by guidance relating to the “time-sensitive acts” whose performance may be postponed in a disaster, as described in IRC 7508A and Rev Proc 2018-58.

Even if the 24-month extension is not available, there are other methods to extend the 31-month window. The most important of these is the “cure period” described in Treas. Reg. Section 1.1400Z2(d)-1(d)(6). This provides that if a qualified opportunity zone fund would fail the 90% “qualified opportunity zone property” test merely because one of its subsidiaries failed one of the to be a qualified opportunity zone business, the Fund may nevertheless treat that business interest as qualified opportunity zone property for the

current semiannual testing date, “provided the business corrects the failure within six months of the date on which the stock or partnership interest lost its qualification.” Thus, in the example above, where the 31-month period ends on 07/2022, the “cure period” would provide an extension of five months, until 12/2022. Note that each qualified opportunity zone fund is only permitted one such correction.

Another helpful rule relates to government delays. Under Treas. Reg. Section 1.1400Z2(d)-1(d)(3)(v)(C), the 31-month safe harbor is suspended during any period in which “consumption of the working capital assets is delayed by waiting for governmental action the application for which is complete.” Prior to the coronavirus crisis, we imagined that an application is “complete” when it is sitting on a bureaucrat’s desk, waiting to be reviewed. It never occurred to us to wonder whether the term also describes documents which are complete but cannot be submitted, due to the municipal office being closed.

Hopefully we won’t have to answer this question; hopefully Treasury will clarify that the 31-month period is suspended due to the coronavirus emergency.

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