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What COVID-19 Means For Opportunity Zone Projects.

The past few weeks have been dramatic as the country and the rest of the world have reacted to the coronavirus pandemic. Businesses are shuttered, residents in some states are under a lockdown (or close to it), schools and universities are closed, and everyone is watching nervously as the stock market tumbles downward while the number of coronavirus cases ticks upward.

While we all try as much as possible to keep our heads together, and protect our investments and our livelihood, here is our advice to those quarantined in the land of opportunity zones.

In-Process Opportunity Zone Projects

Undoubtedly anyone with a project already underway in an opportunity zone is likely nervous about upcoming qualified opportunity fund, or QOF, and qualified opportunity zone business, or QOZB, deadlines. Keep calm and consult the regulations. The final Treasury regulations released in December 2019 contain some explicit relief and some general relief that can likely be of use under these circumstances. We may also get additional relief out of the U.S. Department of the Treasury and the IRS, but this is what we can rely on at the moment.

Additional Time to Get Your Business Up and Running — Disaster Declarations and Tolling for Delays

Any QOZB with a 31-month working capital safe harbor, or WCSH, in place should remember a few important relief provisions.

First, the final Treasury regulations automatically extend the 31-month WCSH for up to an additional 24 months if the QOZB is located in an opportunity zone within a federally declared disaster area.

As of March 31, a number of states and territories have been declared federal disaster areas, including Alabama, California, Colorado, Connecticut, Florida, Georgia, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Missouri, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Washington, D.C., Puerto Rico and Guam.

Projects located in those states or territories can benefit from this 24-month extension as a result of the disaster declarations.

If additional states hardest hit by COVID-19 end up also being declared disaster areas, then any projects located in opportunity zones in those states would get up to an extra 24 months added on to their 31-month WCSHs. There is also an interpretation of the regulations which would treat the declaration of a national emergency as also triggering a 24-month extension nationwide, but it is not clear yet whether the Treasury will explicitly approve this interpretation.

Second, under the general tolling rule, a QOZB can toll its 31-month WCSH for delays caused by waiting for government approval on an application. If you are waiting for any type of approval from a government agency or municipality (building permit, zoning change, etc.), and waiting for that approval causes an actual delay in your project, you can toll the time of the delay for purposes of the 31-month WCSH.

Delays are certain to start kicking in given how many nonessential employees are being told to stay home, but remember that there must be an actual delay on your project as a result of waiting on an application. If you are able to progress the project in other ways while waiting for a particular approval, then you cannot toll for the time waiting.

Even so, given the unprecedented circumstances, it is advisable to document everything. Keep track not only of when various applications were submitted, but also of: (1) when you had to shut down your office, (2) when various government offices where you submitted applications were closed, (3) when you got notice that your architect, contractor or consultant had to close their offices or stop working, and (4) when shelter in place or lockdown orders that affect your project were issued.

If the Treasury expands the tolling rule to pick up COVID-19-related delays, you will want all of this information collected so you can count up the days.

QOF Penalty Relief for COVID-19 Delays — the Reasonable Cause Exception

The existing relief for QOFs at the moment is the reasonable cause exception to the penalty that would otherwise be imposed on a QOF for failing to meet its 90% asset test. This monetary penalty is imposed on a QOF to the extent that its qualifying assets are less than 90%.

The reasonable cause exception was included in the original statutory language in the Internal Revenue Code, and the final Treasury regulations did not expand upon or further define “reasonable cause” for purposes of the exception. In fact, in the preamble to the final Treasury regulations, the Treasury declined to include even a nonexhaustive list of circumstances that would constitute reasonable cause because a determination of reasonable cause is inherently factual.

This is hugely important because if a QOZB fails to be a QOZB for some reason, then the QOF invested in that QOZB could fail to meet its 90% asset test. Remember that for most QOFs, equity in one or more QOZBs will constitute the majority of the QOF’s qualifying assets.

Again, it is crucial right now is to document everything.

If your QOZB fails the 70% tangible property standard because of construction delays, then you want to be able to show that your materials were delayed arriving from overseas.

If your QOZB fails its 50% gross income test because of lockdowns in one of its key markets or because employees were working remotely outside of an opportunity zone, then you want to be able to show that businesses in that area were forced to close down.

If your QOF fails to meet its 90% asset test on a semiannual testing date because the project it was supposed to invest into was put on hold as a result of the pandemic, you should be collecting correspondence showing when and how that deal fell apart.

The inherently factual nature of reasonable cause means that you should be collecting as many facts as possible if you think your QOZB or QOF requirements are at risk.

Capital Raising

On the one hand, capital raising just got a lot harder. Who wants to invest in a 10-year project no less, with so much uncertainty?

On the other hand, anyone who exited the stock market in the past few weeks who realized a capital gain (either long-term or short-term) now has eligible gain to invest in a QOF. The potential universe of investors just got that much bigger. Also, the grim reality is that many small businesses will not survive the forced partial or total closure of their businesses during this time. Remember that a QOF can invest in an operating business QOZB, so any new businesses started in opportunity zones post-pandemic may be prime candidates for QOF investments.

Absent any potential new incentives or guidance (see below), think carefully and strategically about new fundraising right now. Some markets may bounce back as soon as the pandemic is over, and some markets may take a bit longer.

Opportunity zones will need new investment just as much, if not more, than other areas, and with the extra tax incentives, an opportunity zone investment may be especially attractive in just a few months' time. Gains triggered in March could expire as soon as September. Hopefully some of the market uncertainty will have abated by then, so consider gearing up your fundraising efforts so they are ready to go by mid-summer.

Possible Future Relief

In addition to any tax-related relief passed by Congress, the Treasury and the IRS may put forward their own guidance or tax-related relief to the extent possible. Here are some possible opportunity zone related proposals that we hope will be considered. To be clear, these are all right now pie-i--the-sky wish list items and to our knowledge none of these have been proposed or are being actively considered by Congress, the Treasury or the IRS.

Still, if you are in self-isolation and dreaming big, any of these would be a silver lining to the current dreary news cycle:

- Explicit guidance on relaxing certain QOF requirements, such as a free pass on the June 30 testing date for QOFs;
- Explicit guidance on relaxing certain QOZB requirements, such as a free pass on the June 30 testing date for QOZBs. Alternatively, an automatic extension for all 31-month WCSHs in effect during the first half of 2020, or relaxing specific requirements for 2020 such as the 50% gross income requirement which would be helpful for operating businesses;
- An extension on the 180-day reinvestment period for eligible gains triggered in the last quarter of 2019 or the first two quarters of 2020, and 2019 K-1 gains;
- Extra incentives for QOF investments, such as an increase of the 10% basis step-up for investments made prior to Dec. 31, 2021, to 15% or higher;
- Locking in the current capital gains rates for purposes of the Dec. 31, 2026, inclusion in income of eligible gains invested in QOFs;
- Expanding the definition of eligible gains to include certain categories of ordinary income;
- Excluding interim gains from taxation, meaning that any gain from the sale of property by a QOF or QOZB, even before the 10-year holding period, would be excluded from income; or
- Expanding opportunity zones to include all low-income census tracts in each state, rather than the current limitation of 25% of a state's eligible low income census tracts.

Until we hear anything definitive from Congress, the Treasury or the IRS, your best bet on relief from the rigid timing requirements applicable to QOFs or QOZBs is to document everything so you are in good shape to take advantage of whatever guidance or relief we get.

Law360

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April 9, 2020, 6:36 PM EDT

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