



IRS extends relief/suspends penalties for Qualified Opportunity Funds and their investors (Notice 2021-10) Tax Alert

Overview

On January 19, 2021, the Department of the Treasury and the Internal Revenue Service (IRS) issued [Notice 2021-10](#), 2021-7 I.R.B. 888 (Feb. 16, 2021), in response to the ongoing Coronavirus Disease 2019 (“COVID-19”) pandemic, to ensure that opportunity zone tax incentives will continue to bring new investments, jobs, business expansion and new business development to economically distressed communities in the United States. The Qualified Opportunity Zone (QOZ) Program was added to the federal income tax code by the [Tax Cuts and Jobs Act of 2017](#) to authorize the designation of economically distressed communities as QOZs, where new investments, under certain conditions, may be eligible for preferential tax treatment. Electing taxpayers that invest in QOZs through qualified opportunity funds (“QOFs”) can defer and potentially reduce tax on prior capital gains rolled over into such a fund, as well as permanently eliminate tax on future gain arising from appreciated QOF investments held for at least 10 years. Prior to the pandemic, [taxpayers invested an estimated \\$75 billion](#) in QOFs during 2018 and 2019, which QOFs must timely reinvest in QOZ businesses (QOZBs) and business property (“QOZ Business Property”) operating within QOZ census tracts in order to avoid penalties.

Notice 2021-10 extends the relief originally provided to QOFs and their investors under [Notice 2020-39](#), 2020-26 I.R.B. 984 (Jun. 22, 2020) that expired last year. More specifically, Notice 2021-10 makes five changes to the QOZ Program that will make more taxpayers eligible for tax stimulus under the QOZ Program and increase flexibility for QOFs and their respective QOZB subsidiaries required to redeploy their capital into qualifying business development projects in a QOZ. This notice extends the relief originally provided under Notice 2020-39 by:

1. Automatically extending until March 31, 2021, the 180-day period for electing taxpayers (including, among others, individuals, partnerships, corporations, trusts and estates) who recognized certain eligible capital gain on or after October 5, 2019, to roll over such gain into a QOF investment in order to defer, and in some case permanently reduce, the gain that would otherwise have been recognized in the 2019 or 2020 tax year if a deferral election has not been made (extension of the 180-day investment period);
2. Automatically eliminating 2020 and 2021 penalties imposed on certain QOFs that fail to hold on average at least 90% of their assets in QOZ

property, including qualifying direct and indirect investments through a QOZB in QOZ Business Property (collectively, “QOZ Property”), if either (1) the last day of the QOF’s tax year falls between April 1, 2020 and June 30, 2021, or (2) the last day of the first six-month period of the QOF’s tax year falls between April 1, 2020 and June 30, 2021 (**waiver of the 90% investment standard**);

3. Automatically **extending for an additional 24 months the working capital safe harbor period for QOZBs** that have a written working capital plan and schedule in place during any period between January 20, 2020 and June 29, 2021, including both the initial 31-month working capital safe harbor period (for a maximum initial safe-harbor period of 55 months) and the cumulative 62-month working capital safe harbor if an integrated plan is used (for a maximum cumulative safe-harbor period of 86 months) (**extension of the 31-month working capital safe harbor period**);
4. Automatically **tolling from April 1, 2020 through March 31, 2021, the 30-month substantial improvement period** (for a maximum substantial improvement period of 42 months) in which a QOF or QOZB that was not the first person to use tangible property in a QOZ may qualify the property as QOZ Business Property by making additions to the basis of tangible property exceeding 100% of the property’s adjusted basis at the beginning of any 30-month period commencing on or after the date that the property was acquired (**extension of the 30-month substantial improvement period**); and
5. Automatically **extending for an additional 12 months the QOF reinvestment safe harbor period** in which QOFs that received a return of capital from an investment in QOZ Property or proceeds from the sale or disposition of such property between January 20, 2019 and June 30, 2020, may reinvest the proceeds in QOZ Property and treat the proceeds held in cash or cash equivalents as invested in QOZ Property throughout the applicable 24-month period for purposes of satisfying the 90% investment standard, so long as the QOF invests the proceeds in the same manner as it originally intended prior to June 30, 2020 (**extension of the 12-month reinvestment period**).

Detailed explanation

The attached table provides a detailed summary of each form of automatic relief provided to QOFs and their investors under Notice 2021-10, as well as the beneficiaries of such relief and applicable time periods and procedural requirements, if any, to realize these potential benefits.

Five important takeaways from this guidance are as follows:

1. The extension of the 180-day investment period applies retroactively to 2019, meaning taxpayers that have already filed their 2019 federal income tax returns and did not elect to defer eligible gain or make investments in QOZs through a QOF may still do so by making the election to defer gain on an amended 2019 federal income tax return provided this gain amount is invested in a QOF by March 31, 2021. This will permit certain taxpayers to claim refunds for 2019 while investing like amounts in tax-advantaged QOZ investments.
2. The waiver of the 90% investment standard permits all QOFs self-certified as a QOF on or before January 31, 2021, to abate any and all penalties that would otherwise be imposed in tax years 2020 and 2021 for failing to satisfy the 90% investment standard including with respect to investments made in QOZBs that fail to satisfy QOZB requirements during this period. QOFs funded with tax deferred proceeds by January 31, 2021, that will no longer be moving forward with QOZ investments should consider dissolving or

otherwise decertifying on or before December 31, 2021, in order to apply the waiver and avoid penalty.

3. The extension of the 31-month working capital safe harbor permits QOZBs to significantly extend the period of time (up to 86-months in some cases) before the commencement of operations must begin, allowing more patient capital to be raised, provided a written plan and schedule has been established that includes some or all of the period between January 20, 2020 and June 29, 2021. All current QOZBs should reevaluate their working capital plan documentation to ensure qualification for this extension.
4. The extension of the 30-month substantial improvement period permits QOFs and QOZBs to significantly extend the period of time (up to 42-months in some cases) before such entity has more than doubled the basis of property acquired where substantial improvements were occurring at any time between April 1, 2020 and March 31, 2021. For tangible property acquired during this period where substantial improvements also commence, the deadline for completing these substantial improvements is extended until September 30, 2023.
5. The extension of the 12-month reinvestment period permits QOFs an additional 12 months (24 months) to reinvest some or all of the proceeds received from a return of capital, sale, or other disposition of QOZ Property during the 18-month period occurring between January 20, 2019 and June 30, 2020. Only QOFs that received a return of capital or sale or disposition proceeds from QOZ Property by June 30, 2020, will qualify for a 24-month reinvestment period. For example, a QOF that received a return of capital on June 30, 2020, would have until June 30, 2022 (24 months later) to reinvest the proceeds in QOZ Property, without those assets jeopardizing the 90% investment standard, but a QOF that received a return of capital on July 1, 2020, would only have until July 1, 2021 (12 months later) to reinvest, because the QOF's original 12-month reinvestment period did not include June 30, 2020. QOFs that overcapitalized QOZBs should evaluate whether a return of capital received by June 30, 2020, for redeployment in QOZ Property within 24 months would be prudent given the additional time available to reinvest such proceeds.



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