

## IRS extends certain 1031 exchange and Opportunity Zone investment deadlines due to COVID-19



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In response to the 2019 novel coronavirus (COVID-19) pandemic, the Internal Revenue Service (IRS) has issued a series of notices extending the deadlines for many tax filings and tax payments under the Internal Revenue Code (IRC). The most recent of these notices, Notice 2020-23 issued on April 9, 2020, provided limited relief to taxpayers in the midst of specified “time sensitive” actions. This includes both investors seeking to defer capital gains by means of a Section 1031 “Starker” exchange, and investors seeking to defer or permanently exclude a portion of realized capital gains through investments in Qualified Opportunity Zones (Opportunity Zones).

### Section 1031 deadlines extended

IRC Section 1031 allows a taxpayer to defer capital gains from the sale of real estate if the proceeds of the sale are reinvested in another property identified by the taxpayer within 45 days of the relinquished property sale, and acquired by the taxpayer within 180 days of the relinquished property sale.

Notice 2020-23 provides that if the end date of either the 45-day identification period or the 180-day acquisition period falls between April 1, 2020, and July 15, 2020, that date is extended to July 15, 2020. For example, if a taxpayer sold a property on March 1, 2020, the taxpayer’s deadline to identify replacement property would be extended from April 15, 2020, to July 15, 2020. The deadline to close on the acquisition of the replacement property, however, would remain August 28, 2020.

If, instead, the taxpayer had already identified a replacement property, but the 180-day deadline to acquire the replacement property fell between April 1, 2020, and July 15, 2020, then the deadline to acquire the replacement property would be extended to July 15, 2020. Unfortunately, there is no retroactive application to any 1031 exchange in which either the 45-day or 180-day deadline fell before April 1, 2020.

### Opportunity Zone investment deadline extended

Notice 2020-23 also extends timelines in the relatively new Opportunity Zone program. The Opportunity Zone program provides that realized capital gains can be invested in certain property located in Opportunity Zones. An Opportunity Zone investment generally needs to be made within 180 days of the realization of the capital gain in order to be eligible for deferral and potential exclusion of the gain from the taxpayer’s income. Slightly more complex calculations of the 180-day period apply to gains realized from pass-through entities. See [Godfrey & Kahn’s Qualified Opportunity Zones](#) summary for details.

Notice 2020-23 treats this 180-day period as a “time sensitive” action, so that if the taxpayer’s deadline to invest in an Opportunity Zone falls between April 1, 2020, and July 15, 2020, the deadline is automatically extended to July 15, 2020, providing certain taxpayers with additional time to make an eligible Opportunity Zone investment.

*The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice and does not create an attorney-client relationship. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.*

## Additional Opportunity Zone relief

The 31-month working capital safe harbor in the Opportunity Zone regulations applicable to Qualified Opportunity Zone Businesses (QOZBs)<sup>1</sup> has been extended for an additional 24 months if the QOZB is located in any federally-declared disaster area. Given that all fifty states and most U.S. territories are subject to a disaster declaration as of April 3, 2020, this extension should be applicable to almost any existing Opportunity Zone project. The regulations also contain a provision tolling the 31-month requirement to the extent that a project is delayed as a result of the inability to obtain a necessary governmental approval. This may be somewhat limited in practice, as most governmental agencies have continued to hold meetings and grant permits and other approvals on a regular basis.

The Opportunity Zone statute includes a provision which allows a QOZB to avoid certain monetary penalties for “reasonable cause.” There is no specific IRS guidance applicable in the Opportunity Zone context regarding what constitutes sufficient “reasonable cause” to avoid penalties.<sup>2</sup>

Taxpayers who have invested in Qualified Opportunity Zone Funds and/or QOZBs should make sure that those funds and businesses are consulting with their tax and legal advisers regarding the effects of the COVID-19 pandemic. Further, it is important to pay close attention to further pronouncements from the IRS and U.S. Department of the Treasury regarding additional relief that may be forthcoming.

<sup>1</sup>The Opportunity Zone program requires that less than 5% of a QOZB's property be “nonqualified financial property,” such as certain cash or cash equivalents, debt, and stock. However, nonqualified financial property does not include “reasonable” amounts of working capital for up to 31 months, if there is a qualifying working capital plan in place. Therefore, this 31-month working capital safe harbor treats a QOZB's cash, cash equivalents, short-term debt instruments, and certain other financial instruments as “reasonable” and not disqualifying under the nonqualified financial property limit. In general, to qualify for the safe harbor, a QOZB must have a written plan that identifies the working capital as held for the acquisition, construction, or substantial improvement of tangible property in an Opportunity Zone; a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets within 31 months of the receipt of such assets; and the QOZB must substantially comply with the schedule.

<sup>2</sup>Final Treasury Regulations note that the determination of whether there is reasonable cause for penalty relief in a particular case is inherently factual. The Treasury Department and the IRS have determined that the appropriate standards for determining whether the reasonable cause exception to the penalty applies in a particular case are the general standards set out in the Penalty Handbook, which is included in Internal Revenue Manual at Section 20.1. The Treasury Department and the IRS will consider whether Opportunity Zone specific guidance is necessary in the future.