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No written plan relief may stymie opportunity zone projects

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The IRS recently extended opportunity zone deadlines to provide relief to projects facing delays due to the COVID-19 pandemic, but the agency's silence on amendments to written plans may jeopardize ventures that unexpectedly need to change course.

The Internal Revenue Service recently issued guidance providing automatic deadline relief to qualified opportunity funds, allowing opportunity zone businesses an extra 24 months to move cash into projects. Normally if a fund operates a qualified opportunity zone business, then no more than 5% of a qualified opportunity zone's assets can be held as cash or other financial property.

Final regulations provided a working capital safe harbor so QOZ businesses can hold more money for up to 31 months if they create and are "substantially consistent" in following a written plan, including a schedule of how money will be used in future development. The rules allow the government to extend that period by another 24 months if there is a federally declared disaster.

However, the IRS did not explicitly say whether a company can amend its written plan if a project has to make substantial changes due to the novel coronavirus, which causes the respiratory disease COVID-19, according to Steven R. Meier, a tax partner at Seyfarth Shaw LLP.

This is especially problematic for investors in hotels, restaurants and entertainment facilities that may want to develop multifamily units or distribution centers instead because the economic landscape has drastically changed since projects were originally put in place, Meier said.

"With projects that are underway and invested into the business, there remains a quandary as to how to deal with possibly having to radically adjust a business plan," Meier said. "It would have been nice for the IRS to acknowledge that plans that went into place in the middle of March this year are probably about as good as the paper they're written on."

Joseph B. Darby III, a tax partner at Sullivan & Worcester LLP, told Law360 that he has many clients who want to change their written plans, since the coronavirus pandemic has put a damper on opportunity zone projects currently in the works.

"Many people are just not sure what to do and whether they'll be able to proceed," he told Law360.

In many instances, the projects are not following a written plan or schedule due to construction delays or unavailability of workers, so many are considering whether to make adjustments or whether changing the plan will result in disqualification from the opportunity zone program's tax benefits, he said.

The final rules require a QOZ business to have a written plan that identifies the financial property that will be held to acquire, construct or substantially improve property in the zone. The plan must have a written schedule that is consistent with ordinary business operations, under which the property is used within 31 months, but that deadline has been extended by another 24 months because of COVID-19. The regulations also require that the business must be "substantially consistent" with the written plan and schedule.

Uncertainty remains in how the government will decide how a project can be "substantially consistent" with a written plan and its schedule, Darby said. If investors want to be successful as they figure out how to navigate business challenges created by the pandemic, it would be helpful to know what changes, if any, to a written plan are acceptable and what cannot be changed, he said.

Organizations such as the Opportunity Zones Working Group of Novogradac & Co. LLP have asked the government for temporary relief that would allow businesses to modify such plans. Many entities have had to change their plans dramatically in response to the COVID-19 crisis "so they can prosper in the post-pandemic world," the Novogradac group said in May.

A taxpayer-friendly position could say that if a plan was already written and was affected by COVID-19, modifications should be allowed, Darby said. This approach would be consistent with the final rules because they already allow a safe harbor extension by 24 months if there is a disaster, so it would also make sense to allow necessary plan and schedule modifications due to COVID-19, he said.

Until more is known, Darby said, many of his clients are taking a wait-and-see approach, since they do not know what the IRS will decide or what the business climate may be like six months from now.

Meier said he had also seen many investors in hospitality projects that want to pivot, but they are worried about what will happen to their potential tax benefits if the project is not substantially consistent with the pre-COVID-19 written plan and schedule requirements.

While some projects located near a hospital or university will likely wait it out, since such businesses will likely go forward with construction, other projects that are more leisure-oriented may want to make fundamental changes to their plans to better adjust to dramatic changes in consumer behavior, he said.

If amendments are not allowed, then the purpose of the opportunity zone program — to encourage investment in economically depressed areas — is undermined, since without that flexibility, investors would face the choice of either going forward with a potentially noncompliant project or pulling out of the project entirely, he said.

People do not invest money in funds expecting the money to do nothing, so investors' interests in creating successful projects are aligned with the desire to create businesses that bring long-term value to low-income areas, Meier told Law360.

"If the IRS can write a regulation" on the working capital safe harbor, he said, "they can certainly write a modification to that regulation."

Edward A. Renn, a tax partner at Withers Worldwide, told Law360 that there might already be some leeway in making changes, because he had seen some opportunity zone projects change their plans before the novel coronavirus pandemic began.

"I think in the real world, those [written plans] are not as carved in stone as they're made out to be," he said. "I think people have amended those if their projects have gone faster or slower than they intended."

Given the intention behind the postponement guidance, it would be hard to imagine the government penalizing an opportunity zone project for not, for example, having the foundation of a building in New York set because Gov. Andrew Cuomo shut down the construction site for three months, Renn said.

"I really don't think you'll lose your qualification or tax-free rollout simply because you're behind on your schedule and this notice didn't give you this specific right to amend it," he said.

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