Department of Finance and Administration

Legislative Impact Statement

Bill: SB196 **Amendment Number: S1**
Bill Subtitle: TO ADOPT FEDERAL INTERNAL REVENUE CODE PROVISIONS CONCERNING OPPORTUNITY ZONES; AND TO PROVIDE STATE TAX INCENTIVES RELATED TO INVESTMENTS IN OPPORTUNITY ZONES.

Basic Change :

Sponsor: Sen. Ingram

SB196 creates § 26-51-460 to add an additional section which adopts federal Internal Revenue Code 1400Z concerning Opportunity Zones. As originally filed, SB196 would have been effective for tax years beginning on or after January 1, 2019. Amendment No. 1 to SB196 moved the effective date for tax years beginning on or after January 1, 2018.

According to the Internal Revenue Service, Opportunity Zones are designed to spur economic development by providing tax benefits to investors. First, investors can defer tax on any prior gains invested in a Qualified Opportunity Fund (QOF) until the earlier of the date on which the investment in a QOF is sold or exchanged, or December 31, 2026. If the QOF investment is held for longer than five years, there is a 10% exclusion of the deferred gain. If held for more than seven years, the 10% becomes 15%. Second, if the investor holds the investment in the Opportunity Fund for at least ten years, the investor is eligible for an increase in basis of the QOF investment equal to its fair market value on the date that the QOF investment is sold or exchanged.

Revenue Impact :

FY2019 - $1 Million Reduction in State General Revenues
FY2020 through FY2026 - $2.6 Million per year Reduction in State General Revenues
FY2027 - $13 Million Increase in State General Revenues
FY2028 – $4.3 Million Increase in State General Revenues

[DFA reviewed the Joint Committee on Taxation (JCT) and Congressional Research Service reports concerning the adoption of tax incentives for investing in Arkansas Opportunity Zones in I.R.C. § 1400Z. The JCT projections adjusted for Arkansas population compared to total U.S., 0.921%, per capita income in Arkansas divided by total U.S., 78.35%, and dividing by 4.5 to account for the relative difference in tax rates. This resulted in a multiplier of 0.1603% of the JCT projections to determine the Arkansas revenue impact. The federal revenue impacts from JCT started with $1.2 billion reduction for FY2018 and then $1.5 to $1.7 billion each year thereafter through FY2025 and then showing a recovery of $8.1 billion for FY2026.]

Taxpayer Impact :

Taxpayers will be able to defer tax on a capital gain from an Opportunity Zone Investment if they invest the money from the gain in a Qualified Opportunity Fund. Taxpayers can delay recognizing a gain until the end of 2026 and exclude 10% of the gain if the fund investment is held for five years 15% of the gain if the fund investment is held for seven years. Taxpayers can completely exclude gain on any further appreciation of the qualified investment if the fund investment is held for 10 years.

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Resources Required :

Update computer programs, tax forms, and instructions.

Time Required :

Adequate time is provided for implementation.

Procedural Changes :

Department employees will need to be educated as well as the tax community.

Other Comments :

To defer the tax on a gain, taxpayers are not required to live, work, or have a business in an Opportunity Zone. The only requirement is that they must invest in a Qualified Opportunity Fund, property or business. The fund, property, or business must invest 90% of its assets in the Opportunity Zone as measured at two specific points each year to qualify. If the 90% investment rule is not maintained throughout the life of the investment, a penalty is charged for each month of non-compliance. The bill does not specify whether the Arkansas penalty shall equal the full federal penalty, but there is also no provision to pay a percentage of the penalty. Arkansas currently has 85 Opportunity Zones. There is no requirement to hire workers, only to invest in property. It is possible to invest in property and merely hold it for possible future gains and qualify for the deferral or exemption.

Legal Analysis :

None.