State of Arkansas
Department of Finance and Administration
Fiscal Impact Statement

Bill: HB1216
Bill Subtitle: TO CREATE THE FREE MARKET ZONES ACT; AND TO EXEMPT A BUSINESS LOCATED IN AN OPPORTUNITY ZONE FROM THE INCOME TAX, THE CORPORATE FRANCHISE TAX, AND THE ELECTIVE PASS-THROUGH ENTITY TAX.

Sponsors:

Rep. Long

Basic Change:

HB1216 creates the "Free Market Zones Act" to provide tax incentives for business entities located in an opportunity zone.

Current law, § 26-51-460, adopts 26 U.S.C. § 1400Z-2 as it existed on January 1, 2018. That section provides reduced income tax liability for a taxpayer who invests in a qualified opportunity fund. The qualified opportunity fund must use the amounts received from a taxpayer to make investments in a low-income community that is designated as a qualified opportunity zone. The Secretary of the U.S. Treasury designated 85 qualified opportunity zones throughout the state based on nominations from the Governor. HB1216 repeals § 26-51-460.

HB1216 provides an exemption from corporate income tax and corporate franchise tax for any business that is located in an opportunity zone and required to file a corporate income tax return. HB1216 also provides an exemption from the pass-through entity tax for any business that is located in an opportunity zone.

HB1216 is effective for tax years beginning on or after January 1, 2025.

Fiscal Impact:

FY2026 - $583M General Revenue Reduction

[Fiscal impact was calculated by multiplying the total tax liability for corporation income tax, elective pass-through entity (PET) tax, and the estimated tax liability of other PET-eligible business income as reported for 2022 by the percentage of the businesses located in census tract counties in Arkansas that have qualified as opportunity zones to the total companies filing returns in Arkansas.

There are 686 census tracts in Arkansas and 85 of those are opportunity zones or 12%. There are 19,777 businesses in Arkansas opportunity zones compared to 159,865 businesses filing income tax returns in Arkansas (also 12%). The fiscal impact was calculated by multiplying the total tax liability for corporation income tax, elective pass-through entity tax, and PET-eligible business income tax reported on Schedule C and E for 2022 by 12% ($1B x 12% = $135M). There are an estimated 85,486 businesses reporting in Arkansas counties that have opportunity zones or 53% of the total reporting that could also easily add or change to an address within the zone to qualify for the exemption for a total impact of $583M. This estimate assumes that only 53% of the businesses located in Arkansas attempt to take advantage of the exemption in Arkansas.

Below is a chart of estimating the impact at different levels of taxpayers attempting to locate within the opportunity zone to claim the credit out of the total businesses located in Arkansas.

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	Current Businesses in AR Opportunity Zones	37% of Eligible Businesses	53% of Eligible Businesses	62% of Eligible Businesses
Businesses	19,777	59,331	85,486	98,885
Fiscal Impact	**$135M**	**$405M**	**$583M**	**$674M**

Taxpayer Impact:

A business located within an opportunity zone will benefit from exemptions on income, franchise, and elective pass-through entity taxes, reducing its overall tax burden. An eligible business must meet specific filing requirements under the corporate income tax or elective pass-through entity tax acts.

Resources Required:

Computer programs, tax forms, and instructions will need to be updated. Programming costs for the Arkansas Integrated Revenue System (AIRS) are estimated at $13,000.

Time Required:

Adequate time is provided for implementation.

Procedural Changes:

Department employees and the tax community will need to be educated on the exemption.

Other Comments:

None.

Legal Analysis:

HB1216 may benefit from an amendment to address the desired effect of repealing § 26-51-460. Taxpayers previously relied on § 26-51-460 to invest in an opportunity zone fund with the anticipation that they would receive a tax benefit when that gain was subsequently realized. The bill is unclear regarding whether the repeal of § 26-51-460 anticipates that taxpayers should continue to receive the income tax benefits they anticipated when the investment was made or if those benefits are to be lost if the gain is realized after that provision of state law is repealed.

HB1216 may benefit from an amendment to define when a business is considered "located" in an opportunity zone. It is not clear how the tax exemption should be applied to a business having multiple locations when some locations are within an opportunity zone and others are not. It is also not clear

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how the tax exemption should be applied to the income of a business when the business has a non-revenue producing location within an opportunity zone (for example, a warehouse or repair facility) and a revenue producing location (for example, a retail store) outside an opportunity zone. Under the bill as currently written, it is unclear whether a physical location is required or if a mailing address within the zone is sufficient.

The pass-through entity tax provides a simplified method for certain individuals to file and pay income tax on income resulting from their participation in a partnership, limited liability company, or Subchapter S corporation doing business in the state. Individual partners, members, or owners are typically required to file an individual income tax return and pay income tax on their respective shares of the business income. The pass-through entity tax allows those individuals to elect to pay their Arkansas income tax liability by jointly filing a pass-through entity return with the other partners, members, or owners. HB1216 exempts a business located in an opportunity zone from the pass-through entity tax. A business operating within an opportunity zone as a sole proprietor will not qualify for a tax exemption under HB1216. Similarly, individuals participating in a partnership, limited liability company, or Sub S corporation operating in an opportunity zone would not receive the tax exemption provided by HB1216 if the partners, members, or owners elect to file their income tax returns individually rather than as a pass-through entity.