4 State Responses To Opportunity Zones

By Jeffrey Friedman, Maria Todorova and Dennis Jansen (June 24, 2019, 11:01 AM EDT)

State legislatures across the country are responding to the recently enacted federal opportunity zone provisions (I.R.C. Sections 1400Z-1 and 1400Z-2) in a variety of ways that could provide significant state tax benefits.

Created as part of the Tax Cuts and Jobs Act of 2017, these new provisions of the Internal Revenue Code are designed to promote growth in low-income communities — designated as opportunity zones — by offering investors the ability to defer, and potentially reduce gains, from selling appreciated property located in opportunity zones.

States have also provided tax benefits associated with opportunity zones. First, the fact that most states conform to the federal capital gain and expensing treatment of an opportunity zone investment means that many states mirror the federal benefits for these investments.[1] Second, some states have decided to sweeten the pot by offering additional tax incentives for opportunity zone investments separate and apart from any state benefits that might result from a state’s conformity to the federal rules.

This article provides an overview of recent approaches taken by four states with regard to opportunity zone investments.

Alabama: Cushion Underperforming Opportunity Zone Investments With a Tax Credit

H.B. 540 — Enacted June 6, 2019

Alabama recently enacted a tax incentive regime designed to attract investors that would otherwise be wary of the 10-year holding period required to take full advantage of the federal opportunity zone benefits. On June 6, 2019, Alabama Gov. Kay Ivey signed the “Alabama Incentives Modernization Act,” which provides a capital gains reduction for investments in “approved opportunity funds.”

To be certified by the Alabama Department of Economic and Community Affairs, or ADECA, as an
approved opportunity fund, the fund must meet a variety of criteria, including deploying a substantial portion of its capital into qualified opportunity zone property in Alabama within certain asset classes, such as rural areas, blighted property, workforce training or affordable housing. An approved opportunity fund must also commit “to investing at least 75% of its committed capital in qualified opportunity zone property located in Alabama.”

The act also allows approved opportunity funds to enter into project agreements with ADECA. These funds may be entitled to “impact investment tax credits” against state income taxes or financial institution excise taxes for projects that do not produce expected returns by the fifth year of the project agreement.

Although these impact investment credits appear to offer significant risk mitigation benefits to opportunity zone investors, there are important limitations. For example, the impact investment tax credit cannot be paid out in the first four years of the project.

There is also a limit to the size of the credit: The calculation of the impact investment tax credit cannot guarantee a rate of return that is more than the 52-week average yield rate for the United States 10-year Treasury note from the prior calendar year (under 2.2% as of June 2019). The total amount of impact investment credits for opportunity zones is capped at $50 million for all taxpayer claims, and the credit is not available for projects that an opportunity fund committed to invest in prior to the effective date of the act.

Alabama’s investment tax credit is also short-term in nature. Unused credits can only be carried forward for five years, which would bring the project to the 10-year holding period required for the full opportunity zone credits at the federal level.

Arkansas: Limit the Credit to In-State Investments

*S.B. 196 — Enacted Feb. 2, 2019*

Arkansas S.B. 196 conforms the state tax code to I.R.C. Section 1400Z-2 for tax years beginning on or after Jan. 1, 2018. For the purposes of this act, an “opportunity zone” means a population census tract located in Arkansas that is designated as a qualified opportunity zone under Section 1400Z-2 as of Jan. 1, 2019.

Unlike Alabama, Arkansas does not require any additional state certification for “approved opportunity funds.” However, as previously reported in Law360, both states’ laws may be vulnerable to a constitutional challenge and may be deemed discriminatory against interstate commerce by restricting the tax incentives to in-state investments.

Indiana: Boost Existing Tax Credits for Property in Opportunity Zones

*S.B. 563 — Enacted May 1, 2019*

In some states, the designation of a qualified opportunity zone can boost a business’s eligibility for other tax credits designed to help economically disadvantaged areas. This method allows states to target subsets of opportunity zone investments that achieve specific development goals.

Indiana S.B. 563 creates a new “redevelopment tax credit” designed to encourage real estate
development. The credit is available for approved expenditures for the redevelopment or rehabilitation of real property located within a “qualified redevelopment site,” which includes vacant land, brownfields with more than 50 acres and properties with vacant buildings that meet certain conditions.

If the qualified redevelopment site also happens to be in a federally designated qualified opportunity zone, then the redevelopment credit can be increased by 5%. This boost can be highly favorable for investors because Indiana’s redevelopment tax credit is assignable and can be carried forward for nine years.

Maryland: Provide Tax Incentives for Job Creation Within Opportunity Zones

S.B. 581 — Enacted April 30, 2019

Maryland takes one of the most expansive approaches to opportunity zone credits. Maryland S.B. 581 establishes the “opportunity zone enhancement program,” which increases other Maryland tax credits for certain businesses investing in federally designated opportunity zones. Businesses eligible for state opportunity zone enhancements include businesses qualified for tax credits under the following Maryland programs:

- Job creation,
- One Maryland economic development,
- Enterprise zone,
- Biotechnology investment incentive,
- Cybersecurity investment incentive, and
- More jobs for Marylanders

Note that businesses can qualify for benefits under Maryland’s program even if it is not otherwise eligible for credits under the federal opportunity zone provisions.

However, the administrative requirements for Maryland’s programs can outweigh the benefit of some tax credits. For example, to obtain the maximum tax credit for certain small business opportunity zone project credits, a business may need community representation on its advisory board, an agreement with community groups or be required to obtain other forms of local approval.

Looking Forward

States will continue to formulate their responses to the federal opportunity zone rules by developing new tax incentive programs. There are more than a dozen bills pending in legislatures across the country that include provisions similar to the recently enacted laws discussed above. However, the time limitations associated with some of the tax programs require businesses to act quickly to maximize the available benefits.
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