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USA Regional Real Estate

Arkansas
Quattlebaum, Grooms & Tull PLLC

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Law and Practice

Contributed by Quattlebaum, Grooms & Tull PLLC

Contents

Quattlebaum, Grooms & Tull PLLC has real estate team members in both of its offices, in Little Rock and Springdale. Its primary practice areas relating to real estate work include banking, environmental and regulatory, land use and zoning, real estate litigation, secured transactions, tax increment financing and agricultural law. The firm has extensive experience in representing world-class developers in a variety of transactions, including commercial leasing, acquisitions and development. It represents national and regional real estate developers, investors, landlords, tenants and lenders in numerous development projects throughout the United States – including shopping centers, distribution centers, office buildings, hotels and luxury condominiums – and has represented developers in Low Income Housing Tax Credit and New Market Tax Credit projects. The firm is counsel to the Arkansas REALTORS® Association and has substantial experience in timber land acquisition, sale and related matters, including oil, gas and other mineral interests.

Authors

Timothy W Grooms is a managing and founding member, who is highly experienced in real estate, banking, commercial transactions, M&A, entity creation and governance. He serves as counsel to numerous real estate industry groups – including the Arkansas Rural Rental Housing Association, the Arkansas REALTORS® Association and the state chapter of the Building and Office Management Association – and has negotiated hundreds of retail, office and commercial space leases on behalf of major national retailers and numerous developers, landlords and tenants throughout Arkansas and the Mid-South. Mr Grooms was actively involved in drafting the Arkansas statutory landlord-tenant code, and authored the state's most widely published work on landlord tenant law. He is a Fellow of the American College of Real Estate Lawyers and the American College of Mortgage Attorneys, a member and former officer of the International Council of Shopping Centers, and a member of the Real Estate Section of IR Global. In addition to Arkansas, Mr Grooms is also licensed to practice law in New York.

J Cliff McKinney II is a managing member of the firm, focusing on real estate, land use and business transactions, having served as lead counsel on dozens of multimillion-dollar transactions throughout the Mid-South region. Mr McKinney was the first attorney in the State of Arkansas to obtain the status of Leadership in Energy and Environmental Design (LEED) Accredited Professional, which allows him to assist clients with environmentally friendly building projects. An Adjunct Professor at the William H Bowen School of Law at the University of Arkansas, he is chair of the Real Estate Law Section of the Arkansas Bar Association, a member of the Commission on Uniform State Laws, and the Arkansas/Oklahoma state director of the International Council of Shopping Centers. In addition to Arkansas, Mr McKinney is licensed to practice law in Mississippi, Missouri, Oklahoma and Texas.

Jeb H Joyce handles a wide variety of transactions as a member of the firm, with an emphasis on commercial real estate. He has represented lenders and borrowers in closing commercial loans, and his work includes the formation of horizontal property regimes, commercial lease negotiation for tenants and landlords, and real estate conveyances. Mr Joyce has substantial experience in the formation and governance of corporate entities, and he regularly provides local counsel opinions in connection with foreign transactions. A Master of Laws graduate in Securities and Financial Regulation from Georgetown University Law Center, Mr Joyce is an Adjunct Professor at the University of Arkansas School of Law, where he teaches real estate transactions, and a member of the International Council of Shopping Centers.

1. General

1.1 Main Substantive Skills
Arkansas requires all attorneys to graduate from an American Bar Association (ABA) accredited law school and pass the bar examination. Arkansas does not recognise a legal specialisation for real estate law. However, a qualified attorney has experience and education focusing on conveyancing issues (purchase agreements and leases), title review skills and a knowledge of real estate financing law. Until recently, it was common for attorneys practising real estate law to also maintain a general practice of law. The current trend is toward attorneys focusing their practice more exclusively on real estate law issues, given the growing complexity of regulatory and business issues.

1.2 Most Significant Trends
Commercial real estate lending has slowed, due in part to regulatory and interest rate concerns. The impact of online retailing on traditional “brick and mortar” retailers, with repercussions on retail developments, has negatively impacted development. Multi-family housing construction, refinances and sales remain very strong as traditional housing models remain in flux.

1.3 Impact of New US Tax Law Changes
Businesses and individuals are bearing the consequences of the enactment of the Tax Cuts and Jobs Act in a multitude of ways. Generally, the more impactful provisions of the Tax Cuts and Jobs Act are as follows:

- corporate tax rate structure;
- qualified business income deduction;
- business interest expense limitation;
- depreciation and amortization;
- expensing of “qualified real property” under Code § 179;
- Qualified Opportunity Zone Program;
- carried interests;
- modification of Code § 1031 to apply only to “like-kind exchanges” of real property; and
- repeal of the partnership technical termination rules.

The issues pending guidance from the United States Department of Treasury make any comments regarding the expected impact of the qualified opportunity zone program too speculative.

The implementation of transactions intending to qualify under the qualified opportunity zone program will require experience and education focusing on federal taxation issues and securities laws issues, as well as general real estate law and entity governance issues.

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On February 19, 2019, Arkansas Governor Asa Hutchinson signed Senate Bill 211 into law, which will reduce the state’s top income tax rate from 6.90% to 5.90% over the next two years (effective January 1, 2020, the top income tax rate will be 6.60%, and effective January 1, 2021, the top income tax rate will be 5.90%).

2. Sale and Purchase

2.1 Ownership Structures
Most commercial real estate is owned by an entity, with the most common being a limited liability company, though corporations and, more rarely, limited partnerships are also used.

Some transactions are structured as tenants-in-common agreements where multiple parties each own an undivided interest in a property, but these arrangements are usually only done in the context of tax-deferred transactions.

2.2 Important Jurisdictional Requirements
There are no special requirements for transferring specific types of real estate; the same instruments are used to transfer all types of real estate.

2.3 Effecting Lawful and Proper Transfer of Title
A title is transferred with a deed. There are three forms of deeds: general warranty deeds, special warranty deeds and quitclaim deeds. Quitclaim deeds provide no promises that a seller has good title to a property. General warranty deeds and special warranty deeds both promise that the seller has title to the property, though they vary in the breadth of the warranties, with special warranty deeds containing fewer assurances than general warranty deeds. Commercial transactions are almost always effectuated with a warranty deed.

A deed must be executed and acknowledged by a notary, and must then be recorded in the county clerk’s office where the property is located.

2.4 Real Estate Due Diligence
Typical due diligence includes:

- review of a title commitment and special exception documents;
- review of a survey;
- review of an environmental site assessment (ie, Phase I);
- a building inspection; and
- a zoning verification.

Lawyers usually review and provide comments on all of these, except a building inspection.

2.5 Typical Representations and Warranties for Purchase and Sale Agreements
Representations and warranties can vary widely in purchase and sale agreements, and many have no representations and warranties. However, the most common are as follows:

- the environmental condition of a property;
- the existence of any pending lawsuits or government actions concerning a property;
- the authority of the parties to enter into an agreement;
- the availability of utilities;
- the zoning designation of a property; and
- a seller's ability to provide marketable title at closing, free of any liens.

The law does not automatically provide for any representations or warranties. However, federal law requires sellers of residences built before 1978 to disclose that the property could have lead-based paint.

A buyer has two typical remedies for misrepresentation: a suit for breach of contract, or a suit for fraud if the misrepresentation was intentional. Some purchase and sale agreements may provide for alternative remedies, such as termination of the agreement or liquidated damages.

Sellers often want to limit the representations and warranties to the "best knowledge" of the seller, which effectively means that the seller will only be held liable if they give an intentional misrepresentation. A seller cannot limit its liability for fraud.

2.6 Important Areas of Law for Foreign Investors
There are no special issues in Arkansas for foreign investors. While the law does not prohibit direct foreign investment, most foreign investors choose to establish an American company to take title to a property.

2.7 Soil Pollution and Environmental Contamination
Under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), any landowner can be held liable for the environmental contamination of a property, even if the buyer did not cause the contamination. Buyers typically hire an environmental consultant to perform a Phase I environmental site assessment to determine the risk of contamination prior to purchasing a property. The allocation of liability is negotiable between a buyer and a seller, but, most often, the buyer agrees to assume the liability after closing, unless the seller intentionally concealed a known problem.

2.8 Permitted Uses of Real Estate Under Zoning and Planning Law
A buyer usually ascertains zoning by reviewing the online records of the municipality where a property is located. It may be necessary to call the planning office in smaller cities that do not have zoning maps online. It is usually prudent to request a zoning verification letter from the municipal planning office, even though these letters are not generally enforceable in court if they contain an error. Most title companies will sell an endorsement to the title policy insuring the zoning designation of the property.

Contract zoning is not permitted in Arkansas, so it is not possible to enter into specific development agreements with municipalities. However, most municipalities offer some derivation of "planned zoning", where the landowner and the municipality can negotiate a zoning designation unique to the property.

2.9 Condemnation, Expropriation or Compulsory Purchase
The government has the right to condemn land for a public purpose. The government must pay just compensation for the land. The government can take land immediately and then litigate over the actual value of the land, though, in practice, the government will usually negotiate for several months prior to taking land. There is no certain way to gauge the risk of a taking, though property near roads that might be expanded in the future is at greatest risk.

2.10 Taxes Applicable to a Transaction
Arkansas assesses a transfer tax of USD3.30 per USD1,000 of the purchase price for the sale of real property. The tax is typically shared equally between a buyer and seller, though this is negotiable. The transfer tax does not apply in certain exempt transactions; for example, Arkansas exempts transfers to subsidiaries and transfers for consideration of less than USD100.

No transfer taxes or recording taxes are payable in connection with transfers of ownership interests in a property-owning company.

2.11 Rules and Regulations Applicable to Foreign Investors
There are no Arkansas-specific rules or regulations that apply to foreign investors.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate
Most commercial real estate transactions in Arkansas are financed through banks. Alternative lenders, such as insurance companies and retirement systems, are less frequent. The state will occasionally provide some or all of the financing, though this is generally reserved for industrial development projects.

Most lenders will require individual guaranties when making loans to privately held companies, and underwriting decisions are often made based on the financial strength of the individual principals of the borrower.

3.2 Typical Security Created by Commercial Investors

The standard security instrument for real property is a mortgage, though a deed of trust can be used as well. The mortgage usually includes a fixture filing.

3.3 Regulations or Requirements Affecting Foreign Lenders

There are no Arkansas-specific rules or regulations that apply to foreign investors.

3.4 Taxes or Fees Relating to the Granting of Enforcement of Security

There are no mortgage taxes in Arkansas. The transfer tax only applies to a sale of real property and is not triggered by a foreclosure or deed in lieu of foreclosure.

3.5 Legal Requirements Before an Entity Can Give Valid Security

An entity must have the legal authority to sign a financing instrument. This is sometimes verified through an attorney's opinion letter, where the borrower's attorney will opine as to the entity's authority.

3.6 Formalities When a Borrower is in Default

Arkansas offers both judicial and non-judicial foreclosure for when a borrower is in default. Judicial foreclosure is the most common method used for foreclosing commercial properties.

3.7 Subordinating Existing Debt to Newly Created Debt

Secured debt can become subordinate to newly created debt when the creditors agree and record appropriate subordination agreements. Tax liens can trump secured debt.

3.8 Lender's Liability Under Environmental Laws

Arkansas law does not impose additional liability on lenders for environmental liability over and above that imposed by federal law. Lenders who hold foreclosed property are generally immune from environmental liability, but can forfeit this immunity by operating the foreclosed property.

3.9 Effects of Borrower Becoming Insolvent

Arkansas follows federal bankruptcy laws if a borrower becomes insolvent and files for bankruptcy. State law, however, governs the perfection of mortgages and deeds of trusts on real estate and security interests in personal property. Lenders run the risk of having their security interests avoided by the bankruptcy trustee if the security interest is not perfected in conformity with state law. With respect to mortgages and deeds of trust, lenders should be sure that the documents are in proper form and properly executed and acknowledged in the manner provided by law prior to recording with the appropriate recording office. Likewise, lenders should be certain that financing statements are in proper form and timely filed in the appropriate recording office.

Lenders can also gain additional protection from insolvency risks through the use of guaranty agreements from principals or affiliates of the borrower. Lenders should also consider the use of forbearance agreements with borrowers. Typical forbearance agreements include provisions acknowledging the validity and enforceability of loan documents, validity and amount of debt, existence of loan defaults, borrower and guarantor releases of lender and the like.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The amount of controls that apply to various aspects of new buildings or refurbishments can vary significantly depending on the municipality, with larger municipalities tending toward applying more controls. Outside of a few special districts established for aesthetic controls, most municipalities do not directly dictate design or appearance standards, as long as the building conforms to the height and size requirements established for a particular zoning district. Practically, some municipalities may want to review design plans before granting zoning changes. Those districts with aesthetic controls typically have more detailed standards for construction and design, and occasionally have review boards.

4.2 Regulatory Authorities

In most cases, a municipality is responsible for regulating the development and designated use of individual parcels of real estate. Larger municipalities use a combination of zoning restrictions and large-scale development plan approval to regulate development.

4.3 Obtaining Entitlements to Develop a New Project

The usual process for obtaining entitlements for a new project or refurbishment is to make an application with the applicable municipality. The typical application seeks: i) rezoning; ii) replatting; and iii) a site plan review. If any entitlement is sought, then an application must be filed. The application is reviewed by municipal staff, and then forwarded to the planning commission for review. The planning commission then makes a recommendation, which is forwarded to the city council for final approval or denial. Any member of the public may comment at any stage during the process. In situations where rezoning is not necessary, the planning commission typically has the authority to grant the final approval instead of just a recommendation.

The planning staff can typically approve very minor variance requests, but more significant variance requests typically run through a separate board of zoning adjustments after review by the municipal planning staff. Some municipalities use the planning commission to perform the variance review function. Decisions of the board of zoning adjustments are final, although they can be appealed.

4.4 Right of Appeal Against an Authority's Decision
The process to appeal a decision falls into one of two categories. If the municipality denies a rezoning, then the appeal must be taken to circuit court. Appeals are rarely successful because a municipality is held to an "arbitrary and capricious" standard, which essentially means that the courts will defer to the municipality's decision, absent some overwhelming reason. If the municipality denies other types of requests, such as a site plan review, then the appeal must also go to circuit court. However, the court will review the case on a de novo basis, which means that it will substitute its judgment for that of the municipality.

4.5 Agreements with Local or Governmental Authorities
Arkansas does not recognize transferable development rights. Typically, the rezoning process requires a developer to donate right-of-way and utilities to a municipality as part of the approval process.

4.6 Enforcement of Restrictions on Development and Designated Use
Municipalities have the authority to deny municipal services to a rogue developer. A municipality can also sue for an injunction to stop a development.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets
Arkansas recognizes the following typical entities that are available to investors:

- s-corporations;
- c-corporations;
- limited liability companies;
- general partnerships;
- limited partnerships;
- limited liability partnerships; and
- limited liability limited partnerships.

Most real estate transactions use limited liability companies, though a significant number use s-corporations.

5.2 Main Features of the Constitution of Each Type of Entity
Limited liability companies are the most commonly used entity to invest in real estate because they have the most flexible structure. They have minimal corporate formalities and a great deal of flexibility.

Corporations are sometimes used to claim different tax treatment that might be beneficial to particular situations.

Partnerships are older entities that are rarely used, except in legacy situations where an entity predates the more efficient limited liability company structure, which only became common in the 1990s.

5.3 Tax Benefits and Costs
Generally, entities classified for federal income tax purposes as partnerships are preferred for multiparty real estate investment from a tax perspective. For investors, the federal income tax benefits of such a classification may include the ability to deduct their distributive share of losses against their share of partnership liabilities, and to generally receive a distribution in-kind of their pro rata share of the real estate owned by the partnership in a non-recognition, or deferral, transaction. Entities classified as a partnership for federal income tax purposes may also afford more flexibility – for example, the partnership agreement (or operating agreement in the case of a limited liability company classified for federal income tax purposes as a partnership) may generally provide for special allocations of tax items and/or the grant of a carried interest to the real estate fund manager (or general partner) or person who renders services to the entity.

Entities that are classified as disregarded for federal income tax purposes generally have the same tax benefits and costs as the investor owning the property in his/her/its individual capacity.

It is generally disadvantageous to use entities classified for federal income tax purposes as electing small business corporations (or s-corporations) or c-corporations to invest in real estate, as a transfer of the real estate out of the entity will be characterized as a deemed sale, resulting in entity level gain to the extent the fair market value of the property exceeds the entity's adjusted basis.

In addition to the above benefits and costs, Arkansas imposes franchise taxes on entities that are domiciled within the state, or on foreign entities that are registered to transact business within the state.

5.4 Applicable Governance Requirements
Limited liability companies have minimal corporate formalities and extensive abilities to establish custom governance requirements. Partnerships, on the other hand, have flexibility in the governance structure but are subject to more

formalities. Corporations, particularly c-corporations, are the most rigid in terms of formality.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The most common method the law recognizes for the use of real property is a lease agreement. Other less common methods include a life estate or a license. A life estate automatically terminates at the death of a party. A license is typically terminable at will, and is usually only used for very short-term arrangements.

6.2 Types of Commercial Leases

The two most common types of commercial leases are traditional leases and ground leases. The principal differences are the length and the amount of control that a tenant has. Traditional leases are typically shorter and a landlord retains control over uses and maintenance. Ground leases are sometimes referred to as "synthetic ownership", where the tenant has almost the same control and responsibilities as the owner, but for a limited duration. Ground leases are typically very long, with 30 years usually being the minimum duration.

6.3 Regulation of Rents or Lease Terms

Arkansas does not control rents or lease terms for commercial leases.

6.4 Typical Terms of a Lease

The length of a lease term is highly variable. For commercial leases, though, a common duration is ten years, with the option to renew for an additional ten years.

The maintenance and repair of a real estate is highly negotiable. Most commonly, a landlord will maintain the common areas, the building envelope and the structural systems, and a tenant will maintain everything else. If the lease is silent, the default is that the tenant is responsible for maintenance.

The frequency of rent payments is also negotiable, though monthly is the most common.

6.5 Rent Variation

Whether a rent amount will stay the same for the duration of a lease is negotiable, but the amount usually increases periodically throughout the lease. The amount usually increases by a fixed percentage, or is tied to the inflation rate.

6.6 Determination of Changes in Rent

If rent is to be changed, how it is done is negotiable. Most commonly, rent goes up by a fixed amount, a fixed percentage or the rate of inflation.

6.7 Payment of VAT

Arkansas does not have a value-added tax (VAT) or other levy on rent. However, a landlord is subject to ordinary income taxes.

6.8 Costs Payable by Tenant at the Start of a Lease

At the start of a lease, tenants usually pay a deposit equal to the first month's rent, plus the first month's rent and common area maintenance charges.

Capital improvements may be paid by the tenant, but in most cases the landlord will contribute some amount towards the cost of improvements. The landlord may also pay for the entire amount of the cost of improvements at the time such improvements are made, with the portion to be paid by the tenant repaid to the landlord over the term of the lease.

6.9 Payment for Maintenance and Repair

Who pays for the maintenance and repair of common areas is negotiable, but most leases require a tenant to reimburse the landlord for their pro rata share of the cost.

6.10 Payment for Services, Utilities and Telecommunications

Utilities and telecommunications services are usually paid for directly by a tenant.

6.11 Insuring Real Estate that is the Subject of a Lease

Typically, a landlord carries insurance on a building and its common areas while a tenant insures the interior of the premises and their personal property. The tenant usually reimburses the landlord for its pro rata share of the landlord's insurance, which usually covers damage from fires, storms and other casualties.

6.12 Restrictions on the Use of Real Estate

A landlord can impose restrictions on a tenant's use of a real estate. Typically, the landlord will restrict the use to one particular activity, such as running a restaurant. The law does not impose further restrictions as long as the use complies with applicable zoning restrictions.

6.13 Tenant's Ability to Alter or Improve Real Estate

Typically, a tenant is only permitted to modify the interior of a premises. Most landlords also want the right to review and approve the plans in advance.

6.14 Specific Regulations

Generally, Arkansas does not distinguish between different categories of real estate.

6.15 Effect of Tenant's Insolvency
Standard federal bankruptcy laws apply in the event of a tenant's insolvency. The bankruptcy court may permit the tenant to terminate the lease.

6.16 Forms of Security to Protect Against Tenant's Failure to Meet Obligations
The most common types of security are security deposits, usually in the amount of one month's rent, and/or personal guaranties from the individual owners of the entity leasing the real property.

6.17 Right to Occupy After Termination or Expiration of Lease
A tenant does not have the right to continue to occupy real estate after the expiry of a lease. A tenant may be evicted through one of several means, but the most common method is to file an unlawful detainer suit against the tenant, which is described in more detail below.

6.18 Right to Terminate Lease
Any failure of a tenant to abide by the terms of a lease agreement can trigger the right to terminate the lease. The most common event is the tenant's failure to pay rent.

6.19 Forced Eviction
A tenant who is in default can be forced to vacate, with the most common method being a suit for unlawful detainer, where the tenant must be given a warning letter three days before filing suit. After the suit is filed and the tenant is served, the tenant has five days to answer the lawsuit. The landlord is entitled to a writ of possession if the tenant does not appropriately answer the lawsuit within the five-day period. The sheriff will assist with the eviction after the courts issue a writ of possession. From a timing perspective, usually the hardest part is serving the tenant with the lawsuit. If the landlord can promptly serve the tenant, and the tenant does not contest the eviction, the tenant can usually be removed within two weeks.

6.20 Termination by Third Party
There are two circumstances where the government may terminate a lease:

- if the government takes the leased premises for a public purpose; or
- if the government enjoins the use of the leased premises because of a violation of the law, such as failure to pay taxes or operating an illegal business.

In the case of taking a leased premises for a public purpose, the government must pay just compensation for the taking. The government will offer an amount that it considers fair, but the tenant and landlord may challenge the amount in court and allow a jury to decide what is fair. The landlord usually receives the entire amount for the value of the premises, while the tenant usually just receives the cost of relocating.

A lender may be able to terminate a lease if it becomes the owner of the premises (ie, landlord/borrower default results in a foreclosure by the lender, or acceptance of the premises by the lender pursuant to a deed in lieu of foreclosure). While dependent on the facts of each situation, a lender is able to foreclose the leasehold interest upon foreclosure of the property. When taking title to a property by a deed in lieu of foreclosure, generally the lender takes title subject to existing leasehold interests. In many situations, lenders, tenants and landlords will enter into subordination, nondisturbance and attornment agreements to govern the rights of the respective parties in the event a lender assumes possession of the premises after a landlord default.

7. Construction

7.1 Common Structures Used to Price Construction Projects
Construction contracts allocate price in a number of ways but generally follow one of three pricing schemes:

- fixed amount (or lump sum price);
- cost-plus a fee (general cost plus a percentage of the cost of the work); or
- cost-plus with a guaranteed maximum price (GMP).

These pricing concepts are project-dependent and address the applicable risk allocation and considerations related to compensable costs; whether additional work is subject to compensation; who obtains the benefit of cost savings; any rights to audit the other parties' records; and situations that call for increases to the compensable costs of the work.

7.2 Assigning Responsibility for the Design and Construction of a Project
Construction projects allocate responsibilities in a variety of manners, depending on the type and complexity of the project. Generally, the contract terms should specify any responsibilities and contractual obligations between the owner, architect, contractor and any subcontractors. Of note, design-bid-build contracts (where an owner has already commissioned the design of a project prior to a contractor providing a price and executing the contract) have become more common in recent years, allocating the responsibility to design the project to the design-build contractor, whereby the project is substantially more undefined at the time the initial contract is entered into.

7.3 Management of Construction Risk
Common devices used to manage risk on a construction project are warranties and indemnifications. As a general rule, an express warranty excludes any implied warranty

with respect to residential projects, but only if the contractual provision expressly covers the standards of workmanship. However, in order for an express warranty to exclude the implied warranties of habitability, sound workmanship and proper construction, the express warranty must expressly warrant the same.

Express indemnity arises by virtue of a contract and holds one liable for the acts or omissions of another over whom he has no control. Arkansas courts have held that the language imposing indemnity must be clear, unequivocal and certain. While no particular words are required, given that the liability of an indemnitor for the negligence of an indemnitee is an extraordinary obligation to assume, a court will not impose it unless the purpose to do so is spelled out in unmistakable terms.

An implied indemnity agreement will only arise when there is a special relationship carrying with it a duty to indemnify, such as an employment versus independent contractor relationship. A party can be a third-party beneficiary to an indemnity agreement. However, a contract, including an indemnification agreement, will not be construed as having been made for the benefit of third parties unless it clearly appears that this was the intention of the parties.

Ultimately, these risk-management options should be specifically noted in the contract so as to ensure enforceability if any future issues arise. Both contractors and owners should be sure to obtain any liability insurance to protect against risk as well.

7.4 Management of Schedule-related Risk

Delays on a project can occur for a variety of reasons. Depending on the cause, and if the delay is excusable or non-excusable, owners can seek compensation for any non-excusable delay on the part of a contractor. Missed deadlines can delay the start of revenues generated by a completed project and can result in losses such as lost profits, extended oversight costs, and the extended cost of professional time and services arising from the delay. Generally, compensable delay is based on the implied contractual obligation not to unreasonably hinder the performance of another party.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Depending on the cost of a project and an owner's relationship with a contractor, owners often seek other forms of security to guarantee a performance under a construction project, particularly with larger commercial projects. Letters of credit and personal guarantees are common on larger commercial projects or costly residential ones.

In order to protect against liens, owners often require the contractor to pay a bond. Payment bonds can substitute for any materialmen's lien filed. While a payment bond does not preclude the filing of a lien, it lessens the effects.

7.6 Liens or Encumbrances in the Event of Non-payment

Under Arkansas's construction lien laws, contractors, subcontractors, material suppliers, architects, engineers, surveyors, appraisers, landscapers and title insurance agents are entitled to materialmen's liens on a project. A construction lien cannot exist in Arkansas without a valid contract with the property owner, whether express or implied through the conduct of the parties. In Arkansas, there are distinct notice requirements that must be satisfied before a lien claimant can assert a lien, which vary, depending on whether the project is commercial or residential. These requirements must be strictly followed in order to obtain a valid materialmen's lien.

Actions to enforce the lien must be commenced within 15 months of filing the lien with the circuit clerk. If no action is taken on the lien by that time, it ceases to exist. In suits to foreclose construction liens, the contractor is a necessary party and must be made a party within the period provided in the act for the enforcement of such liens. Failure to do so results in dismissal of the lien action.

All construction liens have equal priority toward each other without regard to the date of filing of the account or lien, or the date when the labor or material was performed or furnished. With respect to priority against other encumbrances, construction liens date from the time the construction or repair first commenced.

In order to have a construction lien discharged prior to the entry of a final judgment, the owner of the property, any mortgagee or other person having an interest in the property, or any contractor, subcontractor or other person liable for the payment of the construction lien may file a bond with surety, in the amount of the lien claimed, with the circuit clerk or other officer with whom the lien is filed as required by law. Alternatively, a person desiring to contest a lien may bring an action pursuant to the statute, but the issues in the action will be limited to whether the lien was filed in the form required and whether all applicable notice requirements were satisfied. The lien may also be contested by declaratory judgment proceedings.

7.7 Requirements Before Use or Inhabitation

Generally, prior to occupancy or use, local law requires certain obligations to be met, such as the issuance of a certificate of occupancy or the equivalent, and other inspection certificates. Insurance may also require certain conditions to be met prior to obtaining full coverage. The contractor can and often does make these local government requirements part of a construction agreement to protect against potential defective construction claims prior to completion of the project.

8. Tax

8.1 Sale or Purchase of Corporate Real Estate

The sale of corporate real estate is generally subject to federal income taxation. The federal income tax is payable by a seller (or in certain situations the owners of the seller) of the corporate real estate. The applicable rate will vary, generally depending on the federal tax classification of the seller, how long the seller has held the real estate, and the seller's use of the real estate (eg, stock in trade, use in a trade or business, held for investment, allowable depreciation, etc).

Depending on the circumstances, if a seller of corporate real estate is classified as a disregarded entity or a partnership for federal income tax purposes, the applicable federal marginal rates will, for the taxable year 2019, generally range between 10% and 37% (note that the net investment income tax, which is imposed at a rate of 3.80%, and the alternative minimum tax may also apply). Similarly, if a seller of corporate real estate is classified as an electing small business corporation (or an s-corporation), the applicable marginal rates will, for the taxable year 2019, generally range between 10% and 37% (note that the net investment income tax, which is imposed at a rate of 3.80%, and the alternative minimum tax may also apply; and that certain rules applicable to s-corporations that were formerly classified as c-corporations for federal tax purposes can affect the level at which the tax is paid – the shareholder level or the entity level – and thus the applicable rate). The applicable rate with respect to a seller of corporate real estate classified for federal income tax purposes as a c-corporation is, for the taxable year 2019, a flat 21%.

There are no exemptions to the federal income taxation resulting from the sale of corporate real estate. However, certain non-recognition, or deferral, provisions may be applicable (eg, IRC §§ 1031; 1033; 1400Z-2).

Arkansas

Arkansas imposes a state income tax that generally adheres to the federal income tax law. Accordingly, the sale of corporate real estate by an Arkansas resident is generally subject to Arkansas income taxation, as is the sale of corporate real estate when the seller's business is carried on in Arkansas or the corporate real estate is located in Arkansas. Arkansas income tax is payable by a seller (or in certain situations the owners of the seller) of the corporate real estate. The applicable tax rate will vary, generally depending on the tax classification of the seller, how long the seller has held the real estate, and the seller's use of the real estate.

Circumstances depending, if a seller of corporate real estate is classified as a disregarded entity or partnership for Arkansas income tax purposes, the applicable Arkansas marginal rate is estimated for the taxable year 2019 to range between 0% and 6.9% (note that, to the extent gain from the disposition of the corporate real estate constitutes a net capital gain, as defined by the Code, 50% of that net capital gain is excluded in applying the applicable rate, and if the net capital gain exceeds USD10 million then the amount of such excess is also excluded). Arkansas has adopted Subchapter S of the Code. Accordingly, the rates applicable to a seller of corporate real estate that has elected to be an electing small business corporation for Arkansas income tax purposes are generally the same as set forth in the previous sentence (note that certain rules applicable to s-corporations that were formerly classified as c-corporations for Arkansas income tax purposes can affect the level at which the tax is paid and thus the applicable rate). The applicable marginal rate with respect to a seller of corporate real estate that is classified as a corporation but has not elected to be classified as an electing small business corporation for Arkansas income tax purposes is estimated to range, for the taxable year 2019, between 1% and 6.50%.

Similar to the federal tax law, Arkansas provides that taxpayers are not required to recognize gain from the sale of corporate real estate in certain situations. For example, Arkansas has adopted Code § 1033, relating to gain resulting from involuntary conversions, and Code § 1400Z-2, providing income tax incentives for investments in qualified opportunity zones. Although Arkansas has not adopted Code § 1031, it follows the general principle that gain from the exchange of property for like-kind property of a similar value is not recognized.

In addition to the Arkansas income tax, which is the responsibility of the seller of corporate real estate, Arkansas imposes a real property transfer tax on the seller and purchaser of corporate real estate, on the basis of the full consideration for the transferred real estate. By statute, the real property transfer tax is borne half by the seller and half by the purchaser. However, a seller and purchaser can agree to allocate the tax burden differently. Furthermore, certain real property transfers are exempt from the transfer tax (for a list of exempt real property transfers, see Ark. Code Ann. § 26-60-102).

Local

There are no local taxes imposed on the sale or purchase of corporate real estate.

8.2 Mitigation of Tax Liability

Structuring an acquisition transaction as a transfer exempt from real property transfer tax is the general method by which the Arkansas real property transfer tax is mitigated.

8.3 Municipal Taxes

Persons operating a trade, business, profession, vocation or calling within a city in Arkansas are generally required to obtain a business license from that city and pay an annual license fee. Any exemptions that exist would be on a city-by-city basis.

8.4 Income Tax Withholding for Foreign Investors

Subject to certain exceptions, upon a foreign seller's disposition of a US real property interest, the purchaser or recipient of the real estate is treated as a withholding agent and generally required to withhold a tax equal to 15% of the amount realised by the foreign seller upon the disposition. The purchaser or recipient of the real estate is responsible for determining whether the seller is a foreign person; if the seller is a foreign person and the purchaser or recipient of the real estate fails to withhold, the purchaser or recipient may be held liable for the tax.

8.5 Tax Benefits

Depreciation deductions are generally viewed as a tax benefit of owning real estate and, in some instances, the depreciation deductions may be accelerated by obtaining a cost segregation study with respect to the real estate. Furthermore, in certain cases all – or a portion of – the gain resulting from the disposition of the real estate will be subject to federal income taxation at the preferred capital gain rates. Additionally, recognition of the gain from the sale or exchange of real estate may, under certain circumstances, be deferred under Code § 1031. In some instances, the ownership of real estate may result in the owner of the real estate (or the owners of the entity holding the real estate if the entity is classified as a disregarded entity, partnership or s-corporation for federal income tax purposes) receiving a federal (and possibly state) tax credit, which will reduce the overall tax liability of the owner (or, if applicable, the owners of the entity holding the real estate).

8.6 Key Changes in Federal Tax Reform

See **1.3 Impact of the New US Tax Law Changes**.

The Qualified Opportunity Zone Program was enacted as part of the 2017 Tax Cuts and Jobs Act as new Code §§ 1400Z-1 and 1400Z-2. The program generally affords the following federal income tax benefits to an eligible taxpayer who elects into the program and invests, within a specified time period, eligible gain in a qualified opportunity zone fund ("QOF") in exchange for an equity interest issued by the QOF:

- immediate deferral of the recognition of the eligible gain until the date the eligible taxpayer's equity interest in the QOF is sold or exchanged, or until December 31, 2026, whichever is earlier;
- a partial abatement of the deferred eligible gain, provided the eligible taxpayer meets certain holding period requirements with respect to its equity interest in the QOF; and
- at the election of the eligible taxpayer, post-investment appreciation on a sale or exchange of the eligible taxpayer's equity interest in the QOF is not subject to federal income taxation, provided the eligible taxpayer has held its equity interest in the QOF for at least ten years as of the date of the sale or exchange.

Arkansas

Arkansas has adopted Code § 1400Z-2.

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