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Opportunity Zones: An Analysis of the Policy's Implications

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In this article, the authors summarize the opportunity zone incentive in the Tax Cuts and Jobs Act by providing descriptive statistics on the selected zones, outlining considerations for investors, and using data on the new markets tax credit to inform expectations of investors' responses to this policy.

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I. Introduction

Opportunity zones were established in the Tax Cuts and Jobs Act (P.L. 115-97) to encourage economic development and job creation in low-income communities across the United States. This incentive provides investors with the deferral and reduction of capital gains taxes on existing appreciated investments if proceeds are converted into new investments in designated areas, with further exclusion of capital gains on appreciation of the opportunity zone investments if held for 10 years. While the general public remains largely unaware of the incentive, Kevin Hassett, chair of the White House's Council of Economic Advisers and one of the architects of the incentive, stated that opportunity zones "could turn out to be one of the most noteworthy provisions in the law 10 years from now."[1]

The opportunity zone incentive is a unique idea: a broad tax incentive to deploy wealth held in appreciated assets by stimulating free-market investment into low-income areas. After providing an overview and summarizing descriptive statistics of the selected opportunity zones in Section II, this article describes the mechanics of the tax benefit for potential investors in Section III. Section IV analyzes possible outcomes by comparing the opportunity zone incentive with prior "place-based" incentives such as the new markets tax credit (NMTC). Section V outlines considerations for state and local officials by discussing important issues for the

[1] Jonathan Curry, "Hassett Touts Bonuses as Early Signal of Tax Cuts Working," *Tax Notes*, Feb. 12, 2018, p. 958.

implementation and success of the policy. Finally, the article makes recommendations for federal, state, and local reporting requirements to enable future analyses of the effectiveness of the incentive in improving economic conditions in the recipient zones.

II. Designated Opportunity Zones and the Nomination Process

A. Incentive Overview

Opportunity zones are designated low-income communities and include rural, suburban, and urban areas in all 50 states, five U.S. territories, and the District of Columbia. Each state's governor selected up to 25 percent of eligible census tracts as opportunity zones, which were then approved by the U.S. Department of the Treasury.[2] There are 8,762 zones.[3]

A census tract was eligible for the opportunity zone designation if either the median income in the tract was no greater than 80 percent of the area's median family income, or if the tract had a poverty rate over 20 percent.[4] The selected opportunity zones therefore reflect the income disparity across the United States. For instance, 80 percent of the median income for the four highest-income states is higher than the national median income of $69,946.[5] As a specific example, 80 percent of New Jersey's median income is $72,606, 4 percent higher than the national median and 62 percent more than the comparable amount for New Mexico ($44,720).[6] These data suggest that the needs of these low-income areas — as well as the local investment opportunities — will vary greatly across states and zones.

B. Descriptive Statistics on the Selected Zones

Exhibit 1 summarizes key statistics of the confirmed opportunity zones and provides demographic details by state. Data are obtained from the U.S. Treasury Community Development Financial Institutions (CDFI) Fund's website and from the U.S. Census Bureau's American FactFinder. The most populous states have the most zones, including California (879), Florida (427), Illinois (327), New York (514), Ohio (320), Pennsylvania (300), and Texas (628). Puerto Rico also has many zones (861).[7] The zones' average median income level (excluding Puerto Rico) is $45,877, ranging from $32,453 in Georgia to $58,072 in New Hampshire. The average poverty rate across the zones is 28.7 percent, compared with a national average of 15.1 percent.[8] The states with the highest zone poverty rates (31 percent or more) include California, Georgia, Illinois, Kentucky, Louisiana, and Pennsylvania. The designated zones include more than 14 percent of the state population in Mississippi, Vermont, and Wyoming.

A comparison of two opportunity zones shows the variation in the types of communities that could benefit from the incentive. The first, Census Tract 55031021100, is one of Wisconsin's 120 opportunity zones.[9] It includes the town of Superior, with a median income of $41,030.[10] Superior is a Great Lakes transportation hub for trade in ore and timber, whose prominence has declined in recent years as the U.S. economy has shifted to technology and services industries. By comparison, Census Tract 06081612100 is one of California's 879 opportunity zones.[11] With a median income of $53,000, it is located only three miles from Stanford University in the heart of Silicon Valley. This area in East Palo Alto, California could benefit from the

[2] Counties are subdivided into census tracts, which can be thought of generally as neighborhoods with an average population of 2,500-8,000 people. *See* U.S. Census Bureau, "Geographic Terms and Concepts — Census Tract."

[3] U.S. Department of the Treasury, Community Development Financial Institutions Fund, "Opportunity Zones Resources."

[4] Tract eligibility was overseen by the CDFI Fund. States were also able to select census tracts that did not meet the criteria but were contiguous with other qualifying zones, subject to some limitations discussed below.

[5] This median income is calculated using census-tract-level data and differs slightly from the state-level median income of $67,871 from the Census Bureau website.

[6] *Id.*

[7] While states were limited to selecting 25 percent of the low-income tracts as opportunity zones, all 861 low-income tracts in Puerto Rico qualify (IRC section 1400Z-1(b)(3) as added by the Bipartisan Budget Act of 2018).

[8] The amounts including the Puerto Rico zones are $39,968 median income, 30.4 percent poverty rate, and 15.4 percent national poverty rate.

[9] Wisconsin Housing and Economic Development Authority, "Opportunity Zones."

[10] U.S. Census Bureau, "American FactFinder."

[11] California Department of Finance, "Opportunity Zones in California."

sustained success of the nearby venture capital and technology industries. Investment outcomes across these two zones will be a function of the extent to which communities such as Superior and East Palo Alto promote and attract investment capital, as well as investors' preferences for each tract's local opportunities.

C. Nomination Process

The law created three interesting features of the designation process. First, governors were delegated to select the zones and had wide latitude in how this was accomplished. Consequently, there was considerable variation in how zones in each state were selected for federal approval. In congressional testimony May 17, John Lettieri, president and co-founder of the Economic Innovation Group — the organization that first advocated for this policy — highlighted the variation in methods that states used, ranging from proportional distribution of zones among eligible counties to use of data analytics to identify locations poised for economic growth.[12]

A review of each state's opportunity zone website provides additional details on these selection methods. For example, California's Department of Finance originally used an entirely data-driven process that did not incorporate some tract-specific factors, such as student populations that reduce a tract's median income. This process resulted in the designation of tracts with college campuses, including Stanford University and San Diego State University, and was criticized for generating an "incomplete, and occasionally misleading, evaluation of realities on the ground."[13] California responded by issuing revised recommendations that reflected the public response. Colorado reported that it "took public input and collaborated with regional economic development partners who brought extensive human intelligence to the table" in selecting its 126 zones.[14] Many states, including Massachusetts, posted applications so that residents could nominate particular areas for consideration.[15]

Second, the law permitted governors to select contiguous tracts — tracts that neighbor opportunity zones but that did not otherwise meet the income thresholds — to qualify. This provision allowed governors to designate large geographic areas without having to carve out specific nonqualifying neighborhoods. The law limits the designation of these zones to 5 percent of a state's overall designations, and any tract exceeding 125 percent of the median income of the neighboring zone was ineligible.[16] Exhibit 1 shows that a total of 198 contiguous zones were selected, representing 2.3 percent of all zones, or less than half of the permissible limit.[17] Further, 12 states and the District of Columbia did not designate any contiguous zones. Thus, while some selected zones may not meet the low-income definition as required by the statute, there are relatively few of these contiguous zones that are able to receive tax-advantaged investment dollars under this program. However, if investors perceive these higher-income areas to present better investment opportunities, the contiguous zones may receive a disproportionate amount of investment funds.

Third, all governors were allowed to select a minimum of 25 tracts, permitting smaller population states to designate a higher percentage of eligible tracts than otherwise allowed under the statute. Eight low-population states explicitly benefit from this provision and selected a total of 71 additional zones to reach the minimum number of 25 tracts in their respective jurisdictions.[18]

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[12] "The Promise of Opportunity Zones," hearing before the Joint Economic Committee, 115th Cong. (May 17, 2018) (statement of John W. Lettieri, co-founder and president, Economic Innovation Group).

[13] Letter from Steve Glickman and John Lettieri of Economic Innovation Group to California Gov. Jerry Brown (Mar. 9, 2018).

[14] Colorado Office of Economic Development and International Trade, "Opportunity Zones."

[15] Mass.gov, "Opportunity Zone Workbook 3/21/18."

[16] IRC section 1400Z-1(e).

[17] In Minnesota, for instance, only one of its 128 selected opportunity zones is a contiguous tract. Census Tract 27123036000 is located near downtown St. Paul, adjacent to and across the river from two other zones. By adding this contiguous tract, St. Paul identified a long stretch along both sides of the Mississippi River to qualify for the incentive.

[18] States that benefited from this are Alaska (11 additional zones), Delaware (5), Montana (2), North Dakota (12), Rhode Island (5), South Dakota (7), Vermont (13), and Wyoming (16).

III. Eligible Investments and Investment Tax Benefits

A. Eligible Investments and Opportunity Zone Funds

The opportunity zone incentive is intended to enhance the economic performance of specific geographic areas. The law imposes few restrictions on qualifying investment type or purpose, allowing investment across a variety of asset classes to encourage capital flows to the designated zones. For example, investment can range from real estate assets, including single family homes and commercial properties, to small businesses and infrastructure projects.

To participate in the opportunity zone incentive, taxpayers first sell existing investments — such as appreciated stock or real estate — and contribute the cash proceeds up to the full amount of realized capital gains from these investments into an opportunity fund. A qualified opportunity fund is a corporate or partnership entity established for investing in qualified opportunity zone property.[19] Investors in these funds will self-certify their eligibility for the incentive by completing an IRS form and attaching it to their tax returns. A key requirement of these funds is that 90 percent of the fund's assets are qualifying businesses or properties located in the designated areas.[20]

B. Summary and Example of Tax Benefits

Assume an individual made an original investment of $350 in a technology company several years ago that is worth $450 today, resulting in $100 of long-term capital gains. If an investor sold this investment at the end of 2018, he would incur taxes of $20 and retain after-tax cash proceeds of $430.[21] Alternatively, the investor could defer the $20 capital gains tax liability by investing $100 into opportunity zones within 180 days of the sale. The taxes on the original capital gains would be due at the earlier of the sale of the opportunity zone investment or December 31, 2026. This example calculation is included in Exhibit 2.

Under the program, investors receive:

- a deferral on the capital gains tax that would otherwise be due on the sale of appreciated investment assets. The deferral reduces the net present value of the investor's capital gains tax liability;
- a future reduction of 10 to 15 percent of the capital gains tax liability if the investment is held by the taxpayer for five to seven years;[22] and
- a future exclusion of all capital gains earned on the appreciation of the opportunity zones investment if it is held for at least 10 years.[23]

Continuing the example, suppose the $100 opportunity zone investment is sold for $215.89 10 years later, resulting in capital gains on the opportunity zone investment of $115.89.[24] Because the investment was held for more than seven years, the tax due on the original capital gain of $20 will have been reduced by 15 percent to $17. For comparison, this $17 tax liability for the 2026 tax year is approximately $9.18 at the end of 2018 in net present value terms, equivalent to 45.9 percent of the taxes otherwise due.[25] Thus, the combination of the tax deferral and the 10 to 15

[19] IRC section 1400Z-2(d)(1).

[20] *Id*. Qualified opportunity funds are established as either partnerships or corporations. Qualifying opportunity zone property in which the funds can invest includes stock, partnership interests, or property as defined in the TCJA. There remain many open technical questions, including issues related to fund structure, qualifying investment assets, treatment of ordinary gains, and requirements for substantial improvement of property for which additional guidance from Treasury is needed. The IRS has begun to publish some guidance in the form of responses to the opportunity zones FAQ on its website, with regulations expected in fall 2018.

[21] The tax is calculated as $100 of gains, multiplied by the long-term capital gains rate (20 percent). The example ignores any effects of the net investment income tax rate (3.8 percent).

[22] The mechanism to allow for a reduction in capital gains tax is an increase in the tax basis of the opportunity zone investment by 10 percent if the investment in the qualified opportunity zone fund is held by the taxpayer for at least five years, and by an additional 5 percent if held for at least seven years (for a total exclusion of 15 percent of the original gain from taxation). Regulatory clarification is needed as to whether some ordinary gains, including gains that are ordinary under section 1245 and section 1250 recapture, will qualify for deferral.

[23] Opportunity zone designations end by December 2028, and thus additional clarification is needed to ensure that taxpayers who invest after 2018 will continue to receive the exclusion if they hold property for the full 10-year period. *See* Adam S. Wallwork and Linda B. Schakel, "Primer on Qualified Opportunity Zones," *Tax Notes*, May 14, 2018, p. 945.

[24] Assumes an 8 percent annual return on the investment.

[25] Assumes an 8 percent discount rate.

percent reduction in the amount of the liability reduces the net present value of the tax liability by more than half.

Further, because the opportunity zone investment was held for 10 years, the additional $115.89 in gains would be tax free for an additional cash tax savings of $23.18. The total cash tax savings from the opportunity zone investment would be $26.18, equal to the sum of the $3 tax savings from the capital gains tax reduction ($20-$17) and $23.18 from the permanent gain exclusion. The effective tax rate on the total appreciation of $215.89 (of which $100 is attributable to the original investment, and $115.89 is attributable to the appreciation of the opportunity zone investment) is 7.9 percent, less than half of the statutory capital gains tax rate.

C. Related Tax Considerations

There are other tax considerations that make the incentive even more attractive to investors.

First, in addition to the tax savings outlined above, the multiyear tax deferral option embedded in the opportunity zone incentive has intrinsic option value in that it allows a taxpayer to manage her tax liability across multiple years. For example, suppose a couple sold their house to move into a smaller one in anticipation of retirement. The retirees could convert the capital gains into a qualified opportunity fund and realize taxes in retirement, when they will likely have lower income and thus be subject to a lower tax rate.

Second, the tax deferral benefit increases the upfront principal for the opportunity zone investment. Continuing the example from above and assuming that the original gain represents the only capital gains to invest, the investor can place $100 in the opportunity fund rather than the $80 otherwise available after paying capital gains taxes today. If held for less than five years, this additional $20 is effectively a zero-interest-rate "loan" from the government that is repaid when the investment is sold. If the investment is held for five or more years, then the "loan" is repaid at the time of sale, but at a lower amount ($17 in the example above assuming a seven-year holding period), implying a negative interest rate. Further, the gains on these "tax carry dollars" face a zero rate of tax if the opportunity zone investment is held for 10 years.

Third, the tax deferral effects can be further multiplied using leverage to finance the investment project. Continuing the example, assume an individual would otherwise invest $80 after tax in a real estate project financed using 25 percent equity and 75 percent debt, for a total purchase price of $320. With the opportunity zone incentive, the investor now can contribute $100 of equity to invest in even larger projects with a purchase price of $400. This incentive could have additional effects on the amount and contractual terms of debt financing agreements, as well as price effects on property and investments in the zone areas.

D. Additional Tax Considerations for Investors

The law has many important nuances relevant for investors. First, it states that only the amount equivalent to the capital gains is eligible for preferential tax treatment — that is, the $100 in the example above. There are at least two implications of this requirement. The first is that only taxpayers with capital assets — and unrealized gains on those assets — can participate in this incentive. The second relates to the amount that investors will contribute. Specifically, if an individual contributes the entire proceeds from a previous investment (such as the $450 received from selling the appreciated stock) into a qualified opportunity fund, the component not attributable to the capital gain (the $350 in the example) will be subject to regular tax treatment. All appreciation on this component will be subject to tax on the sale of the investment.[26] Therefore, investors will be required to separately track the two components to ensure the appropriate tax treatment. Alternatively, investors may choose to only invest the amount equivalent to the capital gains ($100) in the zones.

Further, recall that the original capital gains liability from an investor's preexisting investment can be reduced by 15 percent if the investor holds the zone investment for at least seven years, and that the original capital gains taxes will be payable as part of the investor's 2026 tax liability. This time

[26]IRC section 1400Z-2(e)(1).

frame means that eligible capital must be invested by the end of 2019 to qualify for the full 15 percent discount. Thus, investors need to react quickly to identify investment projects and establish opportunity zone funds.

Also, the 2026 tax liability ($17 from the example in Exhibit 2) must be paid with other sources of cash, given that the opportunity zone investment must be retained until 2028 to qualify for the 10-year capital gains exclusion. This requirement for cash payments in 2026 could potentially force some investors to sell or recapitalize their investments earlier than the policy would otherwise intend. More guidance is necessary to clarify these and many other questions regarding the implementation and ongoing tax treatment of investments in qualifying zones.

IV. Possible Outcomes Based on Comparison With Prior Place-Based Tax Incentives

A. Comparison With the New Markets Tax Credit

Policies for place-based tax incentives and development programs have been used since the 1970s to encourage the deployment of capital in low-income areas. Examples of these programs include empowerment zones and enterprise cities, both of which were first introduced as part of the Omnibus Reconciliation Act of 1993. Many academic studies have tested the effects of empowerment zones, but the research has produced mixed results — in part due to the difficulty in measuring outcomes because of the variety of incentives concurrently provided to the designated jurisdictions.

The opportunity zone incentive closely resembles the NMTC program, which was created as part of the Community Renewal Tax Relief Act of 2000. This program provides capital to fund a wide class of investments in low-income census tracts. Academic research finds some positive responses to the NMTC. For example, using tax return data, Tami Gurley-Calvez et al. find that the invested funds appear to be incremental or new investment capital, consistent with the policy goal of encouraging individual investors to consider a new asset class.[27] Further, Matthew Freedman finds that areas that receive NMTC funds exhibit a modest decrease in poverty and unemployment rates and small positive effects on total employment and the quality of jobs.[28] Kaitlyn Harger and Amanda Ross also find increases in employment in recipient areas, but the effects are concentrated in manufacturing and retail industries.[29] While these documented effects are generally positive, Freedman states that existing residents may not be the recipients of these improved economic conditions; rather, the recipient neighborhoods are changing through gentrification and the possible crowding out of local residents.

There are several similarities between the NMTC program and the opportunity zone tax incentive. Both reflect the fundamental goal of deploying private capital in low-income neighborhoods to improve local economies. To do so, both policies provide preferential tax treatment for local investments that is predicated on holding the investment for a specific period. The NMTC program provides tax credits for investments held for seven years, whereas the opportunity zone incentive provides capital gains tax reductions over five-, seven-, and 10-year horizons. The two policies also both provide funding at the census tract level.

There are at least two notable differences between these two programs. Qualification for NMTCs requires community development entities (CDEs) to submit a written proposal to the government, which must be approved. Once approved, the CDE then funds the qualified projects and provides investors with the associated tax credits. The CDE must then reapply for additional funding and is evaluated based on

[27] Tami Gurley-Calvez et al. "Do Tax Incentives Affect Investment?: An Analysis of the New Markets Tax Credit," 37(4) *Pub. Fin. Rev.*, 371-398 (2009). While the findings for individual investment are consistent with the intended policy goals, the paper also finds that there is no change in corporate investment dollars, suggesting that companies are not investing additional amounts but rather switching between different investment classes.

[28] Matthew Freedman, "Teaching New Markets Old Tricks: The Effects of Subsidized Investment on Low-Income Neighborhoods," 96 *J. Pub. Econ.* 1000-1014 (2012).

[29] Kaitlyn Harger and Amanda Ross, "Do Capital Tax Incentives Attract New Businesses? Evidence Across Industries From the New Markets Tax Credit," 56(5) *J. Reg. Sci.* 733-753 (2016).

the economic impacts of their previous projects. In contrast, opportunity funds will be able to self-certify, removing a large administrative step in qualification.[30] Second, funding for the NMTC is capped, but participation in the opportunity funds program is not. Because of the limited available funds for the NMTC, only 16.1 percent of applications from 2003 to 2017 received funding.[31] This low percentage demonstrates the excess demand for these types of investments and suggests that there could be a much larger response to the new, more expansive incentive. Further, prior research and analyses of publicly available NMTC data from the CDFI website show that there has been a growing number of approved projects since 2010, confirming investors' continued interest in these grants. Exhibit 3, Panel A, provides the number of approved projects by year for 2001-2015.[32]

Further analyses of the publicly available NMTC data provide insight into potential outcomes from the opportunity zone incentive. Panel B of Exhibit 3 shows that the majority of NMTC funds (82.7 percent) were allocated to metropolitan areas. While high, this proportion in metropolitan census tracts reflects a 2004 amendment to the NMTC statute requiring that a proportionate share of NMTC funds be allocated to nonmetropolitan areas. Thus, we may observe even higher amounts of opportunity zone investments in cities given the lack of an administrative approval process to impose similar restrictions.

Second, analysis of the stated use of NMTC funds provides insight into the types of projects likely to be funded in opportunity zones. Exhibit 3, Panel C, shows that approximately 36.3 percent of the NMTC funds were used for business financing or microenterprise — presumably providing capital for local businesses. Approximately 63.7 percent of the NMTC projects relate to real estate or construction projects, including rehabilitation of existing properties and new construction of commercial properties. This allocation of funds implies that a significant portion of opportunity zone capital may be invested in the construction and real estate sector.[33] In a recent report, the NMTC Coalition stated that the projects financed in 2017 with the NMTC were for manufacturing (18.5 percent); mixed-use properties (17.7 percent); healthcare (13.3 percent); schools (11.8 percent); child and youth services (7 percent); and community services (5.9 percent) — with the remaining 25.8 percent allocated among 13 other categories ranging from groceries to hotels. However, because the approval process for the NMTC prioritizes some types of projects focused on the local population, this allocation may not necessarily be representative of zone projects.[34] These allocations provide a benchmark to compare the types of projects that will ultimately be funded in opportunity zones.

Third, one criticism of the NMTC is that the recipient communities were not geographically dispersed. While 39 percent of census tracts qualified for the NMTC, approximately 50 percent of the selected projects (by count and by dollars awarded) were concentrated in 10 states, as seen in Exhibit 3, Panel D. In contrast, the 10 states with the fewest NMTC projects collectively accounted for only 2.5 percent of projects. Whether a similar distribution will occur with opportunity zones will be a function of investors' preferences and the ability of local governments and community organizations to attract capital into their respective jurisdictions.

Finally, the NMTC program data informs the extent to which disproportionate amounts of investment could be made in contiguous zones, which are zones that do not qualify as low-income under the statute. While some contiguous zones were eligible for the NMTC, a recent report found "no evidence that [investment was] concentrated in eligible tracts adjacent to affluent areas" and

[30] IRS response to "How Does a Taxpayer Become Certified as a Qualified Opportunity Fund?"

[31] NMTC Coalition, "New Markets Tax Credit Progress Report" (2018).

[32] The data used for these analyses were obtained at CDFI Fund, "Data Release."

[33] We are unable to perform analyses of the underlying purposes of these projects with the publicly available data, and thus we cannot comment on the ultimate use of these new facilities.

[34] For example, the NMTC selection process prioritizes proposals that demonstrate some characteristics, such as significant impact to the local community (job creation, services for low-income families, and "innovative activities"); applicants with experience making loans and equity investments in underserved communities; and locations in one of 10 states with historically low NMTC investment. NMTC Coalition, *supra* note 31.

instead that projects were "concentrated in highly distressed census tracts surrounded by other distressed areas."[35] However, these results and other characteristics of the NMTC program may not transfer to opportunity zone funds because of the lack of an upfront government review process. While this feature enables more taxpayers to claim the incentive, it also means that there is little to no oversight to ensure that the types and locations of the projects are consistent with the goal of improving local economic conditions. Instead, the distribution of investment capital will be driven largely by market forces.

B. Comparison With Section 1031 Exchanges

In addition to similarities with previous place-based incentives, the tax incentives for opportunity zones resemble "like-kind exchanges" under section 1031 in that both permit deferral of capital gains tax. However, there is an important distinction between these two sections.

Specifically, section 1031 exchange treatment limits reinvestment of the proceeds from a sale to new investment in a similar asset class, most commonly real estate. In contrast, the capital gains deferral under the opportunity zone incentive applies to any realized capital gain that is invested in any qualifying investments in a designated opportunity zone. For instance, gains from an investment in a mutual fund could be converted into a new real estate investment in an opportunity zone, whereas comparable treatment under section 1031 would require the initial funds to come from an existing real estate investment. Thus, the opportunity zone incentive is structurally less rigid than predecessor policies to accommodate a wider range of investment opportunities.

V. Political Uncertainty and Policy Concerns

A. Legislative Support for the Incentive

The opportunity zone idea was conceptualized in a 2015 white paper by the Economic Innovation Group, a bipartisan Washington organization funded by entrepreneurs, investors, and policymakers. The idea was included in legislation called the Investing in Opportunity Act that was introduced to Congress in 2017 by Sen. Cory A. Booker, D-N.J., Senate Finance Committee member Tim Scott, R-S.C., then-Rep. Patrick J. Tiberi, and House Ways and Means Committee member Ron Kind, D-Wis.[36] The proposal had more than 100 Democratic and Republican cosponsors when it was included in the TCJA, suggesting broad bipartisan support.[37] Given the 50-state nature of the bill and the high degree of latitude states have in designating their zones, elected officials in both parties have expressed strong support for the policy. For example, Joint Economic Committee Chair Erik Paulsen, R-Minn., stated that "opportunity zones hold the promise of flexible, innovative solutions." Similarly, Sen. Martin Heinrich, D-N.M., stated that opportunity zones "can help lift living standards in neighborhoods across the country." Thus, while a concern for any legislation is that Congress will repeal it, the legislative history and broad bipartisan political support suggest that the risk of full repeal of the opportunity zone incentive may be low.

B. Other Policy and Implementation Concerns

There are at least four concerns with the incentive that could jeopardize its long-term success. The first relates to which populations will most benefit from this incentive. While the goal is to improve local economic conditions in low-income neighborhoods, returns on investments may accrue in large part to investors. This can be evaluated by assessing the group of eligible investors relative to ineligible investors. To participate, a taxpayer must have existing unrealized capital gains to roll into an opportunity zone fund. Thus, the tax incentives will be disproportionately claimed by those based on the distribution of appreciated assets within the population.[38]

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[35] *Id*.

[36] S.B. 293, 115th Cong. (2018).

[37] Economic Innovation Group, "Opportunity Zones: History of the Program."

[38] In 2010 families in the top 5 percent income band (with incomes more than $200,000 per year) "held 63 percent of the gross worth of nonresidential assets" and "47 percent of the total value of all capital assets." *See* Congressional Budget Office Joint Committee on Taxation Report, "The Distribution of Asset Holdings and Capital Gains" (Aug. 2016).

Further, because opportunity zone investments are not required to demonstrate specific benefits to the local population, investors may select projects based solely on their financial return, with little local social impact. While this could result in an improvement of local economic conditions, it could raise prices so that existing residents would be forced to relocate.[39] For example, in response to the opportunity zones proposed by California's governor, the California Reinvestment Coalition stated that "this program, as structured, will contribute to displacement of low-income residents and residents of color in the selected census tracts." The extent to which the existing residents reap benefits from investments in the designated tracts is thus an open question.

The second concern relates to investor participation. For the program to succeed, investors will need to realize existing gains (which may be illiquid), establish and raise new funds, identify attractive investment opportunities, and hold investments for a specified duration. These multiple steps introduce several challenges. For example, investors and investment advisers may be unable to act quickly if they are waiting on critical regulatory guidance. Even if guidance is forthcoming, the rules may be too restrictive to encourage investment.[40] Incentives to invest could further diminish if viable opportunities are not identified relatively quickly, given that the policy is only in place for 10 years and that the value of the tax deferral declines each day in net present value terms. Despite these concerns, there appears to be growing interest in the investor community, suggesting that the lack of investor capital may not be a constraint on the effectiveness of this program. Regulatory clarification on many critical items is expected in fall 2018, which may further increase investor interest and participation.

The third concern relates to local governments seeking capital in their home jurisdictions. Given the large number of tracts and the diversity of investment opportunities, some good projects may exist but remain unfunded unless local governments actively pursue and attract investors to their zones. This may be particularly true in the most distressed zones, where investments are likely to be riskier. While the capital gains tax benefits are not predicated on a required certification or approval from the federal, state, or local jurisdiction, mayors and county officials can affect the types of projects selected through their role in granting necessary approvals and permits often needed for large developments. Further, these officials may also attempt to induce investment by providing additional local tax incentives. Thus, an effective strategy for attracting capital will require local officials to be educated about the incentive and to be strategic in attracting projects that can generate returns for both investors and local residents.

Finally, the incentive may present fiscal issues for policymakers and taxpayers. Depending on the level of investor participation, the policy could be quite costly to the federal government. Although investor participation in the incentive is uncapped, the Joint Committee on Taxation's revenue estimates suggested that the incentive will cost taxpayers $1.6 billion over 10 years.[41] This amount seems low relative to the more than $60 billion of authorized credit authority that has been allocated to the NMTC program, which is capped in both size and scope.[42] To the extent that there is a large and enthusiastic response to this incentive by investors, the costs of the forgone tax revenue because of reduced capital gains could be much higher than $1.6 billion. Alternatively, if the incentive induces investors to trigger capital gains that would not have otherwise been realized, then the revenue generated in 2026 and 2027 could be greater than the amounts reflected in the estimate. Whether the government will be willing to extend the policy beyond its existing 10-year window

[39] Adam Looney, "Will Opportunity Zones Help Distressed Residents or Be a Tax Cut for Gentrification?" The Brookings Institution (2018).

[40] For example, guidance could encourage more single-purpose closely held funds to form, which may be less likely to fund necessary investments by diversified, multi-investor vehicles. As an additional example, the requirement to substantially improve existing properties, defined as improvements equal to the tax basis of the property, may present too large a hurdle for many potential investments. Consequently, investments in areas where land values are high, such as New York or Los Angeles, may see limited investor interest, as the expected returns necessary to justify the capital improvements may be insufficient.

[41] This estimate from the JCT shows a government expenditure of $12.4 billion for 2018 through 2025, offset by revenue of $8.1 billion and $2.7 billion for 2026 and 2027, respectively (when the original capital gains deferral period ends), for an overall cost of $1.6 billion.

[42] Includes $15 billion for 2001-2007, with extensions authorizing $5 billion in 2008 and 2009, and $3.5 billion for 2010-2019.

will likely be heavily influenced by the actual cost of the program.

VI. How Reporting Can Inform Analysis Of the Policy

Collecting data and identifying the appropriate metrics to measure the effectiveness of the policy is critical to the ultimate evaluation of the incentive. Given that success can be defined differently depending on the relevant group, parties must be particularly careful to ensure accurate and timely monitoring and reporting for opportunity zone projects.

There are many relevant outcomes that should be measured when evaluating the effectiveness of the policy. One outcome is the extent of taxpayers' participation, including the number, type, and characteristics of investors claiming the incentive. Other important outcomes are the effects on local economic conditions, such as employment rates, business establishments, capital spending, housing and rental prices, and tax revenue (to name a few). Understanding the types of investments made in the zones, as well as the characteristics of opportunity zones that have attracted the most and least amount of capital, is vital in understanding how the effectiveness of the policy varies across the country. Evaluation of these outcomes requires comprehensive and timely data from participating investors, established opportunity funds, and recipient communities.[43] Recommendations for the types of reporting necessary to facilitate these analyses are discussed below in four categories.

A. Fund Reporting via Self-Certification

While the self-certification process is expected to require minimal time and cost from taxpayers so as to maximize participation, data gathered from this process will be critical for evaluating the anticipated investment effects. The IRS has stated as of this writing that taxpayers will attach a self-certification form to their tax return to report the opportunity funds in which they are participating. Details on the funds' intended location, type, and amount of investment, and the number of fund investors, should be included on the form to provide data for analysis in the early years of the policy.

B. Taxpayer Reporting of Capital Gain Deferral

Taxpayers will report the amount of deferred gain attributable to the sale of existing appreciated property on their tax returns. In addition to identifying the amount of gain that will be deferred because of the opportunity zone incentive, information on the source of gains (existing home sales, appreciated stock, etc.), as well as the relative proportion of gains allocated to opportunity zone investments, enables assessment of the types of taxpayers claiming the incentive. This information can be used to study many policy questions and refine future governmental revenue projections. Matching these data to the data obtained in the self-certification process can also be used to measure the extent to which taxpayers select multiple funds and to study whether these funds invest in the taxpayer's local area.

C. Annual Reporting by Opportunity Zone Funds

Opportunity zone funds, as corporations or partnerships, will file annual tax returns. In addition to the requisite information included on the income tax returns, reporting of funds' actual investments — by broad asset classes and by state — permits further analyses of the types of fund investments, as well as the geographic dispersion of the capital across the United States.

D. State and Local Reporting

State and local governments have at least two reasons to measure participation and effectiveness of this incentive. The first is that these governments will need to assess whether they provide additional incentives, such as state tax capital gains relief, for opportunity zone investments. This is particularly relevant in states with high capital gains tax rates, such as California (13.3 percent), and in states with generally high state tax burdens, particularly in light of other TCJA provisions that limit the deductibility of such taxes. To date, there has been no uniform approach to state tax relief for opportunity zone investments.

[43] Several others have called for some reporting requirements regarding the program. For example, in a June 8 letter to Treasury Secretary Steven Mnuchin, Sen. Booker requested annual Treasury reporting to Congress and for Treasury to create clear definitions to limit abuse. This letter also requested that opportunity funds be required to file statements of intent for investment and regular commitments to community benefits.

Second, local data on economic conditions will be necessary to evaluate the broader effects of opportunity zone investment. These data should be collected as quickly as possible to capture conditions preceding opportunity zone investment. Examples of these types of data include housing and rental prices, occupancy rates, number of business establishments, number of employees, number and type of new jobs created, amount of capital spending, and amount of local tax revenue. Many of these data may already be collected by different government agencies. Thus, if municipalities can implement a system to routinely collect these data, local officials can perform a timely analysis of the policy, which in turn can be used to attract better and more effective projects to the jurisdiction. However, these data collection efforts should not be confined to the selected tracts; some data should also be obtained at the state level so that economic conditions across all census tracts (not just selected opportunity zones) can be measured and compared. State governments and researchers can then use these data to perform more precise estimates of the effects of the opportunity zone incentive.

VII. Conclusion

Early interest in the opportunity zone incentive suggests that a meaningful portion of the touted $6.1 trillion of individual and corporate capital gains could be converted into qualified opportunity zone investments through this policy.[44] There are many possible beneficial effects of this incentive, but there will be challenges in implementation and numerous potential unintended consequences. The differing motivations among stakeholder groups suggest that no uniform policy solution will address all of these possible issues. Nonetheless, this incentive presents an opportunity to redirect wealth for the benefit of low-income areas across the United States. We look toward future research on investors' responses to this incentive and how effective it is in spurring economic growth in low-income communities.

[44] *See* Lettieri, *supra* note 12.

Exhibit 1
Descriptive Statistics on Designated Opportunity Zones

This exhibit provides descriptive statistics on demographic information for the 8,762 selected opportunity zones. The chart first presents average amounts for all opportunity zones in the United States. Because census data for Guam, American Samoa, the Northern Mariana Islands, and the U.S. Virgin Islands are not prepared on the same basis as those for the 50 U.S. states, we separately present only the total number of tracts and contiguous tracts in the following line and designate the missing fields with an asterisk. Below this, we present descriptive statistics by each state. Data on the number of zones and contiguous zones are calculated from the full list of designated zones found on the U.S. Treasury CDFI Fund website. Data on the median income, poverty rate, and populations for zones and states are from the U.S. Census Bureau's American FactFinder website (variables S1701, B19113, and B01003). For the zone median income, poverty rate, population, and percent of state population, census tract-level data were used. For the state median income and poverty rate, state-level data were used.

Table 1.

Jurisdiction	Number of Zones	Number of Contiguous Zones	Median Income of Zones	Median Income of States	Average Zone Poverty Rate	State Poverty Rate	Total Zone Population	Percent of State Population
United States	7,826	169	$45,877	$69,946	28.7%	15.1%	31,389,750	9.9%
United States & Territories	8,762	198	*	*	*	*	*	*
By State								
Alabama	158	5	$40,061	$56,828	30.5%	18.4%	610,372	12.6%
Alaska	25	0	$58,045	$87,365	17.1%	10.1%	86,699	11.8%
Arizona	168	8	$39,145	$61,001	30.8%	17.7%	686,222	10.2%

Table 1. ***(Continued)***

Jurisdiction	Number of Zones	Number of Contiguous Zones	Median Income of Zones	Median Income of States	Average Zone Poverty Rate	State Poverty Rate	Total Zone Population	Percent of State Population
Arkansas	85	2	$39,224	$53,123	29.8%	18.8%	367,761	12.4%
California	879	8	$38,734	$72,952	32.5%	15.8%	4,150,434	10.7%
Colorado	126	7	$49,728	$77,130	21.7%	12.2%	491,481	9.2%
Connecticut	72	1	$42,661	$91,274	25.9%	10.4%	268,953	7.5%
Delaware	25	1	$47,777	$73,831	24.5%	12%	91,953	9.8%
District of Columbia	25	0	$43,174	$89,023	29.7%	17.9%	88,663	13.5%
Florida	427	0	$36,159	$59,139	30.7%	16.1%	1,906,489	9.6%
Georgia	260	0	$32,453	$61,328	38.1%	17.8%	1,030,713	10.2%
Hawaii	25	2	$55,859	$83,451	19.6%	10.8%	105,840	7.5%
Idaho	28	2	$47,589	$59,652	22.2%	15.2%	123,830	7.6%
Illinois	327	0	$35,873	$73,714	33.3%	14%	1,168,120	9.1%
Indiana	156	3	$41,052	$62,748	28.3%	15%	536,148	8.1%
Iowa	62	1	$46,646	$69,419	22.3%	12.3%	209,238	6.7%
Kansas	74	4	$46,738	$68,231	24.8%	13.3%	239,305	8.3%
Kentucky	144	5	$39,519	$56,522	31%	18.8%	558,875	12.7%
Louisiana	150	5	$38,480	$58,068	32.3%	19.7%	546,479	11.8%
Maine	32	2	$49,360	$64,294	20.7%	13.5%	112,740	8.5%
Maryland	149	4	$54,772	$92,049	20.2%	9.9%	598,784	10%
Massachusetts	138	1	$49,524	$90,180	22.9%	11.4%	547,360	8.1%
Michigan	288	5	$39,223	$63,958	29.1%	16.3%	891,501	9%
Minnesota	128	1	$50,099	$79,595	24.2%	10.8%	490,740	9%
Mississippi	100	5	$40,478	$50,592	29.3%	22.3%	440,922	14.8%
Missouri	161	8	$39,533	$62,285	27.7%	15.3%	580,936	9.6%
Montana	25	0	$47,369	$63,214	25.7%	14.9%	93,403	9.1%
Nebraska	44	1	$42,327	$69,207	25%	12.4%	143,227	7.6%
Nevada	61	1	$36,021	$62,528	30.2%	14.9%	224,392	7.9%
New Hampshire	27	0	$58,072	$83,709	16.8%	8.5%	123,703	9.3%
New Jersey	169	0	$45,502	$90,757	24.7%	10.9%	734,364	8.2%
New Mexico	63	4	$44,212	$55,900	27.5%	20.9%	258,340	12.4%
New York	514	17	$43,996	$74,036	29.9%	15.5%	2,092,572	10.6%
North Carolina	252	11	$41,499	$59,667	27.3%	16.8%	1,125,539	11.3%

Table 1. *(Continued)*

Jurisdiction	Number of Zones	Number of Contiguous Zones	Median Income of Zones	Median Income of States	Average Zone Poverty Rate	State Poverty Rate	Total Zone Population	Percent of State Population
North Dakota	25	0	$55,766	$77,277	23.9%	11.2%	81,913	11.1%
Ohio	320	3	$36,760	$64,433	30.9%	15.4%	956,488	8.3%
Oklahoma	117	3	$40,463	$59,742	27.3%	16.5%	382,295	9.9%
Oregon	86	5	$52,109	$65,479	24.1%	15.7%	402,233	10.1%
Pennsylvania	300	11	$38,846	$69,960	31.3%	13.3%	966,776	7.6%
Rhode Island	25	0	$47,980	$75,655	25.3%	13.8%	111,651	10.6%
South Carolina	135	7	$41,236	$58,158	28.1%	17.2%	541,967	11.2%
South Dakota	25	2	$49,051	$66,825	26.5%	14%	105,075	12.3%
Tennessee	176	6	$38,999	$57,747	29.3%	17.2%	701,926	10.7%
Texas	628	0	$42,480	$64,585	27.7%	16.7%	2,886,306	10.7%
Utah	46	0	$46,536	$71,058	22.3%	11.7%	205,652	7%
Vermont	25	2	$54,393	$71,465	21.4%	11.6%	91,245	14.6%
Virginia	212	5	$50,029	$80,068	20.7%	11.4%	897,082	10.8%
Washington	139	7	$50,697	$76,507	22.7%	12.7%	586,419	8.3%
West Virginia	55	3	$47,548	$54,409	24.9%	17.7%	202,833	11%
Wisconsin	120	0	$42,652	$69,925	28.2%	12.7%	437,375	7.6%
Wyoming	25	1	$57,399	$73,654	20.5%	11.6%	106,416	18.3%
*Indicates that the requisite data for each of the territories was not available.								

Exhibit 2
Example of Savings

This exhibit provides an example of the capital gains tax deferral on the sale of existing appreciated property; the capital gains tax reduction if the opportunity zones investment is held for seven years; and the capital gains exclusion on appreciation if the opportunity zones investment is held for 10 years. Calculations are based on several key assumptions listed at the bottom of the table and should not be relied on for investment advice.

2018 Tax Deferral From Sale of Existing Appreciated Property	
Proceeds from sale of existing investment	$450
Less: tax basis	-$350
Total capital gain	**$100**
Assumed long-term capital gains tax rate[a]	20%
Deferral of 2018 tax liability	**$20**
2026 Reduction in Capital Gains Tax From Original Sale of Appreciated Property	
Capital gains tax due	$20
Reduction attributable to basis increase[b]	85%
Reduction of 2026 tax liability	**$17**
2018 present value of tax liability[c]	**$9.18**

2028 Exclusion of Capital Gains Tax From Sale of Opportunity Zone Investment	
Opportunity zone investment final value[d]	$215.89
Amount contributed to opportunity zone investment	$100.00
Capital gains from investment	**$115.89**
Assumed long-term capital gains tax rate	20%
Exclusion: 2028 tax liability	**$23.18**
Total Cash Tax Savings	
2026 savings attributable to 15 percent basis step-up[e]	$3.00
2028 savings attributable to gain exclusion[f]	$23.18
Total cash tax savings	**$26.18**
Effective Tax on Original Investment	
Total appreciation on original investment of $350.00 [g]	$215.89
Cash taxes	$17.00
Effective tax rate	**7.9%**

[a]Ignores any effect of the net investment tax.

[b]Assumes that the investment is held for the required 15 percent reduction in seven years.

[c]Present value assuming 8 percent discount rate.

[d]Calculated based on an 8 percent annual return on investment.

[e]Equivalent to the difference between the $20 of tax due in 2018 and the $17 due in 2026 (without discounting).

[f]Assumes investment was held for 10 years.

[g]Includes $100 of appreciation on original investment sold in 2018, as well as $115.89 appreciation on opportunity zone investment.

Exhibit 3
Analyses of New Markets Tax Credit Data

This exhibit provides descriptive statistics on the NMTC for 2001-2015 using publicly available data from the CDFI Fund's website. Panel A presents the number of approved projects by origination year. Panel B reports the proportion of projects in a metropolitan area, as classified by CDFI. Panel C provides statistics on the stated purpose of the NMTC project, and Panel D provides statistics on the proportions of projects by states with the most and least NMTC funding.

Panel A: Number of NMTC Originated Projects by Year

Origination Year	Number of Projects	Cumulative Number
2001	2	2
2002	3	5
2003	15	20
2004	291	311
2005	598	909
2006	742	1,651
2007	1,021	2,672
2008	959	3,631
2009	888	4,519
2010	1,047	5,566
2011	1,307	6,873
2012	1,245	8,118
2013	1,174	9,292
2014	1,085	10,377
2015	1,143	11,520
Total	**11,520**	

Panel B: Proportion of Projects in a Metropolitan Area

Location of Project	Number of Projects	Percent of Projects
Metropolitan area	9,521	82.7%
Nonmetropolitan area	1,999	17.3%
Total	**11,520**	**100%**

Panel C:
Stated Purpose of Investment

Purpose of Project	Number of Projects	Percent of Projects
Business Financing	4,159	36.1%
Microenterprise	24	0.2%
Real Estate		
Commercial Construction	3,755	32.6%
Commercial Rehabilitation	3,174	27.6%
Residential Construction	174	1.5%
Residential Rehabilitation	47	0.4%
Other	187	1.6%
Total	**11,520**	**100%**

Panel D:
Distribution of NMTC Across States

States	Percent of Total Projects	Percent of Total Dollars Benefit
10 States With the Most NMTC Projects		
California	8.7%	8.7%
Ohio	7.2%	5.2%
Massachusetts	5.8%	4.5%
Missouri	5.6%	4.4%
Louisiana	5.5%	6.1%
New York	5.3%	7.3%
Wisconsin	4.3%	4%
Pennsylvania	4.0%	3.6%
Illinois	3.9%	3.3%
Total	**50.3%**	**47.1%**
10 States With the Fewest NMTC Projects		
Vermont	0.4%	0.5%
Nevada	0.4%	0.2%
Idaho	0.4%	0.2%
South Dakota	0.3%	0.3%
Delaware	0.2%	0.3%
Hawaii	0.2%	0.3%
Kansas	0.2%	0.2%
North Dakota	0.2%	0.2%
West Virginia	0.2%	0.2%
Wyoming	0.1%	0%
Total	**2.5%**	**2.4%**

■