Opportunity Zones and Race

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Abstract

The Opportunity Zone (OZ) tax incentive enacted in the Tax Cuts and Jobs Act of 2017 is the latest place-based tax incentive to encourage investments in distressed communities. The law provides for favorable tax treatment of capital gains that are reinvested into qualified opportunity funds (QOFs) as well as potential elimination of the capital gains taxes on the QOF investment within designated census tracts.

Controversy has ensued over which census tracts were designated as Opportunity Zones and over the types of investments which have resulted. Although intended to encourage private investment in high-poverty or low- to moderate-income neighborhoods in designated Opportunity Zones (12% of all census tracts in the U.S.), press reports continue to highlight dubious projects. For example, a New York Times article speaks of billions invested in luxury apartment buildings and hotels, storage facilities, and student housing in college towns. The lack of community benefit guidelines and reporting requirements in the initial legislation and subsequent regulations appear to result in investments that fail to address the wide disparities in access to economic opportunity in these Opportunity Zones.

Early assessments of the OZ tax incentive finds that there are too many census tracts designated as Opportunity Zones leading to excessive competition between zones. Also, investment is concentrated in real estate instead of businesses and in urban rather than rural areas. Economists Kennedy and Wheeler's analysis of preliminary 2019 data confirms that just 16% of the 8,764 designated Opportunity Zones have received substantial investment capital, and that most of these capitalized Opportunity Zones were already experiencing capital investment at the expense of the other 84% of the Opportunity Zones that received no investment. Furthermore, most OZ investment is concentrated in those tracts where population, educational attainment, incomes, and home values are increasing while the proportion of elderly and non-white residents is declining. Reforms must be made to the OZ tax incentive to ensure that the types and locations of the projects are consistent with the goal of improving local economic and social conditions.

This project will analyze the OZ tax incentive through the critical tax lens to determine what impact this incentive has on historically disempowered groups, in particular people of color. This aligns with President Biden's executive order stating that the federal government should "pursue a comprehensive approach to advancing equity for all, including people of color and others who have been historically underserved." This requires each agency to evaluate whether and the extent to which its "programs and policies perpetuate systemic barriers to opportunities and benefits for people of color and other underserved groups."

The Joint Committee estimates that an average $3.4 billion per year of revenue will be foregone over 2019-2023 on account of these special provisions making it imperative to perform such analysis. The possibility of community benefit must not be left to chance. It must be an intentional part of the OZ tax incentive tool, especially given the magnitude of the taxpayer revenue foregone and the incidence of the tax benefit to the wealthy. It is not appropriate for tax expenditures to be funding investments that do not benefit the residents of those Opportunity Zones.

As part of our analysis, we analyze the demographic differences between eligible and designated Opportunity Zone census tracts using American Community Survey data. We also use harmonized longitudinal census data to look at demographic and economic change in eligible and designated opportunity zones from 1970 to present. Finally, we examine the coincidence of designated Opportunity Zone census tracts with historic residential security maps to question the extent to which Opportunity Zones are concentrating capital investments in those spaces that have been historically disinvested in as a matter of federal policy. We conclude by making recommendations regarding the reform of the OZ incentive.