The Promise and Perils of Opportunity Zones

Thursday, September 12, 2019
WELCOME

Tupa Hoveka
Program Associate, Field Engagement
Contact: thoveka@prosperitynow.org
AGENDA

- Overview of Opportunity Zones
- The Flaws of Opportunity Zones
- What Can Advocates do to Ensure Opportunity Zones Embody Equity and Full Inclusion?
- Q&A
This webinar is being recorded and will be available online within one week.

All webinar attendees are muted to ensure sound quality.

**Ask a question any time** by typing the question into the text box of the GoToWebinar Control Panel.

If you experience any technical issues, email gotomeeting@prosperitynow.org.
TODAY’S SPEAKERS

Emanuel Nieves
Associate Director, Prosperity Now
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Samantha Jacoby
Senior Tax Legal Analyst, CBPP
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Chris Schildt
Senior Associate, PolicyLink
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Emanuel Nieves
Senior Policy Manager, Prosperity Now
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The mission of the Asset Building Policy Network (ABPN), a coalition of the preeminent civil rights and asset-building organizations—including Prosperity Now and PolicyLink—together with a financial institution, is to expand economic opportunities for low-income members of communities of color and close the racial wealth gap.

In addition to developing and promoting research and program solutions aimed at generating savings and strengthening household financial resiliency within communities of color, the ABPN focuses on systems and policy change across a range of areas—from financial services to entrepreneurship to immigration to the tax code—that impact wealth creation.
Prosperity Now’s mission is to ensure everyone in our country has a clear path to financial stability, wealth and prosperity.
We open doors to opportunity for those who have been kept off the path to prosperity.

We help people build wealth by making sure they have what they need to build a better future.

We enable meaningful mobility through research, policies and solutions.
Founded in 1981 to analyze federal budget priorities, the Center on Budget and Policy Priorities (CBPP) is nonpartisan research and policy institute.

In this capacity, CBPP pursues federal and state policies designed both to reduce poverty and inequality and to restore fiscal responsibility in equitable and effective ways.

To do so, CBPP applies deep expertise in budget and tax issues and in programs and policies that help low-income people, in order to help inform debates and achieve better policy outcomes.
PolicyLink is a national research and action institute advancing racial and economic equity to deliver and scale results in the following arenas:

• **Equitable Economy**: Promote economic inclusion and ownership to eliminate poverty, shrink inequality, and increase mobility.

• **Healthy Communities of Opportunity**: Create and maintain opportunity-rich communities in all neighborhoods and all regions of the country through strong networks and social capital, equitable development, and infrastructure investments that enable low-income people and communities of color to thrive.

• **Just Society**: Build power and expand agency to ensure that all systems and institutions are just, free of racial bias, and lead to a vibrant democracy where all, especially the most vulnerable, can participate and prosper.
THE FEDERAL TAX CODE

Annual Spending on Asset-Building Tax Programs Since 1994

SOURCE: From Upside Down to Right-Side Up: Redeploying $540 Billion in Federal Spending to Help All Families Save, Invest and Build Wealth, Prosperity Now
WHO BENEFITS FROM THE TAX CODE
PRIOR TO CURRENT LAW, THE TAX CUTS AND JOBS ACT

SOURCE: Prosperity Now analysis of Office of Management and Budget data

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WHO BENEFITS FROM THE TAX CODE UNDER CURRENT LAW, THE TAX CUTS AND JOBS ACT

Share of Tax Cuts from the Tax Cuts and Jobs Act

72%

Richest 20% of Households

Earning $110,000 or more


28%

Bottom 80% of Households

Earning $110,000 or less

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### Who Benefits from the Tax Code
**Under Current Law, The Tax Cuts and Jobs Act**

<table>
<thead>
<tr>
<th>Average Tax Benefit from the Tax Cuts and Jobs Act</th>
<th>Households, By Income Group</th>
<th>Daily Benefit from the Tax Cuts and Jobs Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>$90</td>
<td><strong>LOW-INCOME HOUSEHOLDS</strong>&lt;br&gt;Earning less than $23,000</td>
<td>$0.25</td>
</tr>
<tr>
<td>$1,000</td>
<td><strong>MIDDLE-CLASS HOUSEHOLDS</strong>&lt;br&gt;Earnings between $40,000–$110,000</td>
<td>$2.75</td>
</tr>
<tr>
<td>$47,650</td>
<td><strong>RICHEST 1% OF HOUSEHOLDS</strong>&lt;br&gt;Earning more than $590,000</td>
<td>$130.55</td>
</tr>
</tbody>
</table>

**Source**<sup>1</sup> Race, Wealth and Taxes: How the Tax Cuts and Jobs Act Supercharges the Racial Wealth Divide, Prosperity Now, ITEP

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[prosperitynow.org](http://prosperitynow.org)
WHO BENEFITS FROM THE TAX CODE

UNDER CURRENT LAW, THE TAX CUTS AND JOBS ACT

Share of Overall Tax Returns Compared to Share of Total Tax Cuts from the Tax Cuts and Jobs Act

<table>
<thead>
<tr>
<th>Share of Overall Tax Returns</th>
<th>Share of Tax Cut from the Tax Cuts and Jobs Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asian Taxpayers</td>
<td>3.7%</td>
</tr>
<tr>
<td>Black Taxpayers</td>
<td>5.5%</td>
</tr>
<tr>
<td>Latino Taxpayers</td>
<td>10.2%</td>
</tr>
<tr>
<td></td>
<td>5.0%</td>
</tr>
<tr>
<td>White Taxpayers</td>
<td>11.9%</td>
</tr>
<tr>
<td></td>
<td>67.0%</td>
</tr>
<tr>
<td>Top 5% of White Taxpayers</td>
<td>43.5%</td>
</tr>
<tr>
<td></td>
<td>79.5%</td>
</tr>
</tbody>
</table>

SOURCE: Institute on Taxation and Economic Policy’s microsimulation model
ABOUT OPPORTUNITY ZONES

• Introduced by Senator Tim Scott (R-SC) in 2017 as the Investing in Opportunity Act, the Opportunity Zones (OZs) program was enacted as part of the Tax Cuts and Jobs Act of 2017 on a bipartisan basis.

• According to the Internal Revenue Service, OZs are defined as an “economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment.”

• Under the program, governors in each state and territory, as well as the mayor of DC, were given the power to designate Opportunity Zones for investment in low-income and high-poverty census tracts.
  • According to the Economic Innovation Group, more than 8,700 qualified OZs census tracts have been certified by the U.S. Treasury Department across all states, territories, and the District of Columbia.
  • According to PolicyLink out of 100 million people in America who are economically insecure (living at or below 200 percent of the federal poverty level), approximately 20%—19 million—of them live in the census tracts designated as Opportunity Zones.
ABOUT OPPORTUNITY ZONES

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ABOUT OPPORTUNITY ZONES

How do Qualified Opportunity Fund Investments Work?

Sample Calculation of Capital Gains Tax on a QOF Investment Held for Seven Years

You start with a traditional investment
Initial Investment $1M

Sold for $2.5M

Capital Gain $1.5M

You can pay capital gains tax now

Calculate Capital Gains Tax
Gain $1.5M
Capital Gains tax rate 23.8%
Tax Due $357K

Post-Tax Earnings $2.143M

Or you can transfer your gain to a qualified opportunity fund (QOF)

(Shares in a sports stadium in this example)

If you hold your QOF for seven years

You now get an increased basis on your gain, $1.225M

Which gives you a new calculated gain of $1.275M*

Calculate Capital Gains Tax
Gain $1.275M
Capital Gains tax rate 23.8%
Tax Due $303,450

Post-Tax Earnings $2,196,550
Tax Savings: $53,550

BONUS: If you hold your QOF investment for 10 Years

QOF investors can permanently exclude from taxation any capital gains that accrue after their investment in a QOF.

Investors can increase their original cost basis, $1M, by 15 percent of their original gain that was transferred ($1.5M) into the QOF, if the investment is held for seven years.

*New Calculated Gain is selling price of gain invested minus increased basis ($2.5 million-$1.225 million). This calculation does not include any earnings made from the QOF investment.
ABOUT OPPORTUNITY ZONES

Points of Concerns:
• Past efforts to use tax incentives to spur economic development in distressed areas have produced mixed results.

• Rules and regulations put forward by the administration so far have ignored the needs/concerns of potentially impacted communities, focusing instead on providing rules of the road for investors/investments.

• Tracking impact and benefits of these Zones/funds on the most vulnerable members of these communities remains unclear.

• Potentially subsidizing investments that were already planned.

• Opportunity Zones ignores housing challenges.

• Numerous substantive and technical corrections are likely to be needed for Opportunity Zones to meet the underlying bill’s/Congressional intent.
Samantha Jacoby
Senior Tax Legal Analyst, CBPP
Contact:
OZ Statute Exhibits Three Main Flaws

- Failure to target the neediest places
- No specific requirements for investments to benefit low-income residents of OZs
- Large potential for tax avoidance and gaming
OZ Designation Process Allows Investments in “Outlier” Zones to Qualify

• Definition of “low-income community” (LIC) – 80% of median income or 20% poverty rate
• Contiguous with a LIC and 125% of median income
• Other ways to qualify
Types of “Outlier” Zones

Gentrifying areas (e.g., Brooklyn)

High-investment urban areas (e.g., Vegas Strip, Houston)

College towns (e.g., Berkeley, Charlottesville)
“Outlier” Zones Can Absorb a Large Share of OZ Investment

- Assume 7% of OZs were “bad” designations
- Each tract has ~5,000 residents, and there are ~8,800 OZs
- ~3 million Americans live in poorly targeted OZs (i.e., zones that didn’t need help)
- Law and proposed regs lack guardrails to prevent most OZ investment from going to these zones
Incentive Structure May Not Encourage Socially Beneficial Investments

- Wealthy investors are the direct beneficiaries of tax breaks
- Communities can only gain if there are spillover benefits (not guaranteed)
- Structure of tax break encourages investment in highest-return activities (e.g., high-end real estate)
OZ Investment Generates Significantly Larger Tax Breaks for High-Return Investments

<table>
<thead>
<tr>
<th></th>
<th>Affordable Housing</th>
<th>Luxury Condo Building</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Non-OZ Investment</td>
<td>OZ Investment</td>
</tr>
<tr>
<td>Pre-Existing Capital Gain</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Up-Front Tax on Original Capital Gain</td>
<td>($238,000)</td>
<td>N/A</td>
</tr>
<tr>
<td>After-Tax Proceeds Invested</td>
<td>$762,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Year 10 OZ Investment Value</td>
<td>$1,143,000</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Pre-Tax Annual ROI</td>
<td>4.14%</td>
<td>4.14%</td>
</tr>
<tr>
<td>Deferred Tax on Original Capital Gain</td>
<td>N/A</td>
<td>($202,300)</td>
</tr>
<tr>
<td>Tax Owed on OZ Capital Gain</td>
<td>($90,678)</td>
<td>N/A</td>
</tr>
<tr>
<td>Total After-Tax Investment Value</td>
<td>$1,052,322</td>
<td>$1,297,700</td>
</tr>
<tr>
<td>Post-Tax Annual ROI</td>
<td>0.51%</td>
<td>2.64%</td>
</tr>
<tr>
<td>After-Tax Profits</td>
<td>$52,322</td>
<td>$297,700</td>
</tr>
</tbody>
</table>

Note: Includes 3.8% net investment income tax (NIIT). Assumes a 20% capital gains tax. Assumes OZ investment is held for at least 10 years and otherwise qualifies for the tax breaks.

cbpp.org
Loopholes and Vague Requirements Encourage Tax Avoidance

• Substantial improvement/original use requirement
• 50% gross income requirement
• Rules related to intangible property (e.g., IP)
• Anti-abuse rule
Example – Land Banking

• Buyer buys a building in an OZ from Seller.
• Buyer requires Seller to demolish the building as a condition to the sale.
• Buyer doesn’t have to make investments in the now unimproved land.
• Buyer has to run a “business”; could use the land as a parking lot or lease it.
• Buyer can hold the land for >10 years and all appreciation is tax-free on sale.
Example – Sale/Leaseback

• A business owns its HQ in an OZ prior to 2018
• The building can’t be OZ property unless it’s substantially improved
• The business could sell the building and enter into a sale-leaseback agreement; the lease counts as OZ property.
Example – IP shifting

- Unlike tangible assets (e.g. buildings, equipment), an OZ business’s intangible assets (such as IP) can be purchased from a related party and need not be improved.
- Ex: a publicly traded software company sells IP to a subsidiary OZ business; 10 years later, the company sells the subsidiary to an IPO vehicle; all appreciation is tax-free.
Chris Schildt
Senior Associate, PolicyLink
Contact:
The Promise and Perils of Opportunity Zones

Federal legislation’s stated goals:

- Poverty reduction
- Job creation
- New business starts

Aspirational equitable Opportunity Zone results:

1. Protect residents from displacement;
2. Create good jobs for local residents;
3. Grow local business opportunities;
4. Reduce poverty;
5. Create wealth-building opportunities; and
6. Increase community infrastructure, services, and supports.
Community Principles

**Equitable growth** Opportunity Zones should leverage tax incentives to create good jobs, increase economic security and mobility, and eliminate the racial wealth gap for low-income residents and residents of color in the zones.

**Development without displacement** Development in Opportunity Zones should foster greater housing affordability and security for families most at risk of displacement, including low-income households and households of color.

**Healthy communities of opportunity** Projects should increase services available to vulnerable populations such as affordable transportation options, health-care facilities, healthy food retail, and quality education services.

**Community-centered** All policies and investments should be shaped and vetted through a community process that will center the needs of the most vulnerable, including low-income communities of color.
Fulfilling the Promise of Opportunity Zones

- **Community groups**
  - Organize and advocate for anti-displacement protections, equitable investments, policy reform/repeal.

- **Investors**
  - Develop investment portfolios based on community needs, equity standards.

- **Local/state governments**
  - Zoning and regulatory authority to protect against bad investments, encourage equitable investments.
  - Performance metrics and data analysis.
Performance Metrics and Data Analysis

People
- Racially-disaggregated population
- % <200% poverty
- Employment rate
- Median wage and income
- Wealth
- Opportunity youth
- Educational attainment
- Life expectancy

Place
- Housing tenure
- Rent burden
- Rent tenure
- Building permits
- Minority-owned businesses
- Affordable housing
- Vacant properties
- Public transportation stops

Economy
- # jobs created, salary, entry/advancement
- Local and ppl of color hire
- Local MBE business contracting/creation
- Funds led by ppl of color
- # investments in DBEs
OZ Equity Performance Standards

- **Job creation – construction and regular jobs**
  - 40% local/ppl of color targeted hire
  - Living wage and basic benefits for all entry-level workers
  - MBE utilization goal (not below 10%)
  - MBE creation

- **Affordable housing creation**
  - Min 20% LI and VLI for all new construction

- **Community infrastructure, services, and supports**

- **Equitable development mitigation funds**
  - Dedicate % of fund, profits to support community organizing, workforce dev, mitigate displacement, etc.

- **Policy advocacy**
- **Resident profit-sharing**
Fulfilling the Promise of Opportunity Zones

- Engage local residents throughout process
- Develop equitable development standards for OZ investments
- Enforce standards through local zoning and permitting authority
- Incentivize good behavior and responsible investment
- Advocate for federal tax policy reform – we can do better!
• **PolicyLink:** [Opportunity Zones - Guiding Principles and Perspectives](#)

• **CBPP:** [Opportunity Zone Regulations Favor Investor Flexibility Over Community Protection](#)

• **CBPP:** [Potential Flaws of Opportunity Zones Loom, as Do Risks of Large-Scale Tax Avoidance](#)

• **LISC:** [Navigating the Opportunity Zones](#)
What questions do you have?

Share them in the Questions box!
TODAY’S SPEAKERS

Emanuel Nieves
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Contact: enieves@prosperitynow.org

Samantha Jacoby
Senior Tax Legal Analyst, CBPP
Contact: sjacoby@cbpp.org

Chris Schildt
Senior Associate, PolicyLink
Contact: cschildt@policylink.org
Expand Your Networks with the Prosperity Now Community

Sign up for listservs and working groups, volunteer to facilitate peer discussions, serve in a leadership role and more!

- Racial Wealth Equity Network
- Adult Matched Savings Network
- Affordable Homeownership Network
- Financial Coaching Network
- Taxpayer Opportunity Network (VITA/community tax prep)
- Campaign for Every Kids Future — Children’s Savings Accounts
- Health and Wealth Network
- Innovations in Manufactured Housing (I’M HOME) Network

Visit any of the networks above at prosperitynow.org/getinvolved to get started.
Take action with Prosperity Now Campaigns!

Sign up to stay informed about the latest developments and opportunities to take action by joining one of our four federal policy campaigns.

<table>
<thead>
<tr>
<th>HOMEOWNERSHIP</th>
<th>CONSUMER PROTECTIONS</th>
<th>SAFETY NET</th>
<th>TURN IT RIGHT-SIDE UP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Homeownership is key to building wealth. Together, we will advocate for products and policies that provide more affordable homes to more people.</td>
<td>Consumer protections create fairer, more transparent financial markets. Together, we will ensure consumers keep the safeguards they deserve.</td>
<td>Safety net programs help protect vulnerable individuals and families from falling deep into poverty. Together, we will protect programs like SNAP, IDAs and more to help those in need when they need it most.</td>
<td>The vast majority of tax incentives go to those at the top, not to those who need it most. Together, we will turn our upside-down tax code right-side up.</td>
</tr>
</tbody>
</table>

Visit any of the Campaigns above at [https://prosperitynow.org/take-action](https://prosperitynow.org/take-action) to learn more and join.
Prosperity Now Advocacy Center
Take action today at https://prosperitynow.org/take-action

Here you can:

- Email a MOC
- Call a MOC
- Tweet at a MOC
- Schedule a Meeting
- Sign a petition
Thank You!

Please complete our survey!