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Opportunity Zones Providing Opportunity for Whom?: How the Current Regulations Are Failing and a Solution to Uplift Communities

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Abstract

In 2017, the newly enacted Tax Cuts and Jobs Act created an incentive for taxpayers to invest in Qualified Opportunity Zones—census tracts that consist of low-income communities. These investments, which are incentivized via lucrative tax deferral benefits, are intended to uplift communities and leave them in a better position than they were pre-investment. However, the initiative lacks regulation requiring investments to actually benefit low-income areas, resulting in money going to places that do not need help, while communities that are in need may face displacement. This is a result of many wealthy investors finding that luxury projects are the easiest to finance, while others have even lobbied to have state officials designate specific plots of lands, that are not low-income at all, as Opportunity Zones. This Note explores how the Opportunity Zone legislation contributes to the pervasive income and wealth disparities in America and proposes additional regulations that could result in meaningful investments that benefit underserved communities.

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Table of Contents

"Those are pretty sweet set ups—real cap gains advantages."

"The tax breaks are supposed to be for the benefit of downtrodden neighborhoods to stimulate investment development."

"And treadmills were originally built as a system of punishment for convicts—hard labor—milling grain, not firm-bunned soccer moms."[1]

I. Introduction

Throughout the United States, income inequality has grown markedly.[2] America's top 10% earners now average an annual income that is more than nine times as much as those in the remaining 90%.[3] A key factor contributing to the income and wealth disparity is the preferential tax treatment of long-term capital gains.[4] For instance, "[t]he higher the income group. . . the larger the share of income derived from investment profits."[5] Conversely, Americans who are not in the highest income tax bracket receive the majority of their income from wages and salaries.[6] As such, this preferential tax treatment of long-term capital gains facilitates the wealthy's becoming even wealthier and

1. *Billions: Opportunity Zone* (SHOWTIME television broadcast May 24, 2020).

2. *See generally* Chad Stone, Danilo Trisi, Arloc Sherman, & Jennifer Beltrán, *A Guide to Statistics on Historical Trends in Income Inequality*, CTR. ON BUDGET & POL'Y PRIORITIES, https://www.cbpp.org/research/poverty-and-inequality/a-guide-to-statistics-on-historical-trends-in-income-inequality (last updated Jan. 13, 2020) (highlighting broad trends and the widening inequality in income over the past seven decades) [perma.cc/YQF8-2EVR].

3. *See generally Income Inequality in the United States,* INEQUALITY.ORG, https://inequality.org/facts/income-inequality/ (detailing the large disparity in annual income between those in the top 10%, 5%, 1%, and 0.1% as compared to those in the bottom 90%) [perma.cc/R8WY-LCSK].

4. *See id.* (explaining that the top marginal tax rate for the richest Americans in the highest tax bracket is 37%, while the highest rate that applies to long-term capital gains is 20%).

5. *Id.*

6. *See id.* (noting that between 2009 and 2018, the bottom 90% had wage and salary income growth of 6.8%, compared to 19.2% for the top 0.1% earners).

is a factor that contributes to the exacerbation of the disparity in both the income and wealth gap.[7]

In December of 2017, Congress enacted the Tax Cuts and Jobs Act.[8] The Act introduced incentives for investors to invest in areas designated as "Opportunity Zones."[9] Qualified Opportunity Zones are population census tracts that consist of low-income communities that have been nominated and designated as such according to a specific procedure.[10] States may nominate an area to be an Opportunity Zone, which must then be certified by the U.S. Secretary of the Treasury.[11]

The objective in enacting Opportunity Zones was to spur economic development in these low-income communities.[12] Investors are incentivized to invest in the zones by receiving tax benefits provided by deferred taxation of their earnings.[13] In order to invest in an Opportunity Zone, investors must have unrealized

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7. *See Wealth Inequality in the United States*, INEQUALITY.ORG, https://inequality.org/facts/wealth-inequality/ (defining wealth as a representation of a person's net worth, in other words, the sum of an individual's total assets minus liabilities, and that wealth inequality is more pervasive than income inequality in America) [perma.cc/5W5U-D59V].

8. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017).

9. *See* I.R.C. § 1400Z-1 (2018) (implementing the new legislation that allows taxpayers to defer taxes if they reinvest capital gains in an area designated a qualified Opportunity Zone).

10. *See id.* (defining low-income community as a population census tract with a poverty rate of at least 20% or, in the case that the tract is not within a metropolitan area—the median family income of the tract does not exceed 80% of statewide median family income).

11. *See* I.R.C. § 1400Z-1(b) (2018) (stating that the chief executive officer of the state in which the tract is located may nominate a zone for qualification).

12. *See* Investing in Opportunity Funds, 85 Fed. Reg. 1,866, 1,897 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) ("In developing the proposed regulations . . . the Treasury Department and the IRS intended to strike a balance between providing taxpayers with a flexible and efficient process for organizing QOFs, while ensuring that investments in such vehicles will be properly directed toward the economic development of low-income communities.").

13. *See The Power of Tax Deferral, Why it May Pay to Delay*, GOLDMAN SACHS, https://www.gsam.com/content/dam/gsam/pdfs/us/en/advisor-resources/sales-library/variable-annuity/power-of-tax-deferral.pdf?sa=n&rd=n (Feb. 28, 2018) ("The power of tax deferral is straightforward: [P]ostponing taxes on any earnings generated within your investment portfolio can allow more of your investment returns to compound over time, resulting in potentially higher long-term returns.") [perma.cc/FT4L-GRTS].

capital gains from the sale of a capital asset.[14] These gains can then be rolled into a Qualified Opportunity Fund (QOF), which is a vehicle used to invest in an Opportunity Zone.[15] Investors may: (1) Defer taxation on any prior gains invested in a QOF until the earlier of either the date on which the investment in a QOF is sold or exchanged, or December 31, 2026; (2) receive a 10% exclusion of the deferred gain if the QOF investment is held for longer than five years; (3) receive a 15% exclusion of the deferred gain if the QOF investment is held for longer than seven years; and (4) if the investor holds the investment in the Opportunity Fund for at least ten years, they become eligible for an increase in the basis of the QOF investment equal to its fair market value on the date that the QOF investment is sold or exchanged.[16] Thus, the tax treatment of Opportunity Zone investments is far more preferential than the already preferential treatment of taxes on capital gains.[17]

Generally, capital gains are profits from the sale of a capital asset.[18] "Capital assets are significant pieces of property such as homes, cars, investment properties, stocks, bonds, and even collectibles or art."[19] When a capital asset is sold, the difference between the adjusted basis in the asset and the amount realized from the sale of the asset is classified as a capital gain or loss.[20] A

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14. *See* I.R.C. § 1400Z-2 (2018) (providing a tax deferral for capital gains reinvested in Opportunity Zones).

15. *See* I.R.C. § 1400Z-2(d) (2018) (defining a "qualified opportunity fund" as an investment vehicle organized as a corporation or partnership for the purposes of investing in qualified Opportunity Zone property).

16. *See* I.R.C. § 1400Z-2 (2018) (providing the logistics and tax consequences of investing in an area designated an Opportunity Zone).

17. *Compare* I.R.C. § 1400Z-2 (2018) (explaining the permissible tax deferrals on gains from investments in Opportunity Zones), *with* I.R.C. § 1(h) (2018) (providing that the capital gains tax rates will generally be between 0% and 20% depending on the taxpayer's income tax bracket).

18. *See* I.R.C. § 1221 (2018) (defining capital assets as property held by the taxpayer with certain exclusions for property used in the individual's trade or business that is subject to the allowance for depreciation provided in section 167, or real property used in their trade or business); I.R.C. § 1222 (2018) (defining other terms related to capital gains and losses).

19. Alicia Tuovila, *Capital Asset*, INVESTOPEDIA, https://www.investopedia.com/terms/c/capitalasset.asp (last updated Nov. 12, 2020) [perma.cc/29HY-VA6U].

20. *See Topic No. 409, Capital Gains and Losses*, I.R.S., https://www.irs.gov/taxtopics/tc409 (last updated Jan. 19, 2021) (defining the asset's basis generally as its cost to its owner) [perma.cc/6TCP-DHQX].

capital gain results when "you sell the [capital] asset for more than your adjusted basis."[21] A capital loss results if "you sell the [capital] asset for less than your adjusted basis."[22] Furthermore, capital gains and losses are classified as long-term or short-term.[23] Lower tax rates generally apply to long-term capital gains versus ordinary income.[24] For most individuals, the tax rate on capital gains is no higher than 15%, however, for very high-income individuals this preferential rate is higher.[25] Thus, the tax treatment of Opportunity Zone investments is far more preferential than the already preferential treatment of taxes on capital gains.[26]

Areas designated as Opportunity Zones are intended to be regions that have lower income levels, higher poverty rates, and higher unemployment rates than eligible non-designated tracts.[27] However, where communities are already experiencing high levels of socioeconomic change, further investment could possibly displace low and moderate income residents.[28] Policy analysts have

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21. *Id.*

22. *Id.*

23. *See id.* ("Generally, if you hold the asset for more than one year before you dispose of it, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term.").

24. *See id.* (explaining that there are a few exceptions in which case capital gains may be taxed at rates higher than 20%).

25. *See* I.R.C. § 1(h) (2018) (providing that for individuals whose income is $0 to $39,375, the long-term capital gains tax rate is 0%, for those who earn $39,376 to $434,550 it is 15%, and for those earning over $434,551 it is 20%).

26. *Compare* I.R.C. § 1400Z-2 (2018) (explaining the permissible tax deferrals on gains from investments in Opportunity Zones), *with* I.R.C. § 1(h) (2018) (providing that the capital gains tax rates will generally be between 0% and 20% depending on the taxpayer's income tax bracket).

27. *See What are Opportunity Zones and How Do They Work?*, TAX POL'Y CTR. URB. INST. & BROOKINGS INST., https://www.taxpolicycenter.org/briefing-book/what-are-opportunity-zones-and-how-do-they-work (last updated May 2020) (answering frequently asked questions pertaining to how to invest in Opportunity Zones and how the zones function as a tax break incentive) [perma.cc/RAR3-JTBV]; Investing in Opportunity Funds, 85 Fed. Reg. 1,866, 1,901 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) ("In particular, the Treasury Department and the IRS note that section 1400Z-2 was enacted to encourage the development of operating businesses in QOZs and thereby increase the economic development of the communities located in those designated census tracts.").

28. *See* TAX POL'Y CTR. URB. INST. & BROOKINGS INST., *supra* note 27 (indicating that Opportunity Zones in those areas may be less likely to benefit low-income residents).

expressed concerns that Opportunity Zones in these areas may inadvertently exacerbate the problem of unemployment and poverty in these tracts.[29] Because the period of investment in order to benefit from deferred capital gains taxes is five, seven, or ten years, the economic growth in the Opportunity Zones could be temporary, and could ultimately leave areas in a more destitute position than they were before.[30]

Additionally, there is concern about whether the designation process is appropriate to lift low-income communities.[31] Section 1400Z includes no requirement that local residents and businesses actually benefit from these investments.[32] "Even supporters of the initiative agree that the bulk of the opportunity-zone money is going to places that do not need the help, while many poorer communities are left empty-handed."[33] Over 200 of the 8,800 federally designated Opportunity Zones are adjacent to poor areas but are not themselves considered low income.[34] "Backers of the

29. *See id.* (finding that designated zones have "lower incomes, higher poverty rates, and higher unemployment rates than eligible non-designated tracts").

30. *See* Samantha Jacoby, *Potential Flaws of Opportunity Zones Looms, As Do Risks of Large-Scale Tax Avoidance*, CTR. ON BUDGET & POL'Y PRIORITIES (Jan. 11, 2019), https://www.cbpp.org/research/federal-tax/potential-flaws-of-opportunity-zones-loom-as-do-risks-of-large-scale-tax (providing examples of luxurious investment projects in Oakland and New York that are being selected for their financial return, not their social impact resulting in accelerated gentrification, dislocation of current residents, and few jobs created) [perma.cc/L7MA-36SF].

31. *See* Scott Eastman & Nicole Kaeding, *Opportunity Zones: What We Know and What We Don't*, TAX FOUND. (Jan. 8, 2019), https://taxfoundation.org/opportunity-zones-what-we-know-and-what-we-dont/ ("While opportunity zones present certain budgetary and economic costs, it is unclear whether opportunity zone tax preferences used to attract investment will actually benefit distressed communities.") [perma.cc/W9Y6-SNL4].

32. *See* Adam Looney, *Will Opportunity Zones Help Distressed Residents or be a Tax Cut for Gentrification?*, BROOKINGS INST. (Feb. 26, 2018), https://www.brookings.edu/blog/up-front/2018/02/26/will-opportunity-zones-help-distressed-residents-or-be-a-tax-cut-for-gentrification/ ("It's a subsidy based on capital appreciation, not on employment or local services, and includes no provisions intended to retain local residents or promote inclusive housing.") [perma.cc/2AHZ-6ZQR].

33. *See* Jesse Drucker & Eric Lipton, *Meant to Lift Poor Areas, Tax Break Is Boon to Rich,* N.Y. TIMES (Sept. 1, 2019) (reporting that some Opportunity Zones that were classified as low-income based on census data from several years ago have since gentrified).

34. *See id.* (stating that up to 5% of the zones need not be poor in order to

program say that luxury projects are the easiest to finance, which is why those have been happening first."[35] In some cases, developers have lobbied state officials to include specific plots of land inside Opportunity Zones that are not low-income at all.[36]

One example of such lobbying or perceived influence is illustrated by billionaire Richard LeFrak.[37] "Developer Richard LeFrak, one of the president's buddies from his New York real estate days, appears to have given [Donald Trump's inaugural committee] $150,000."[38] LeFrak is working on a 183-acre project set to include twelve residential towers and eight football fields' worth of retail and commercial space in Miami.[39] LeFrak's team encouraged city officials to nominate the area around the site as

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enable governors to draw zones in ways that would include projects or businesses just outside poor census tracts, potentially creating jobs for low-income people).

35. *See id.* (noting that some proponents of the program hope that luxury project deals will be eclipsed by ones that produce social benefits in low-income areas).

36. *See* Justin Elliot, Jeff Ernsthausen & Kyle Edwards*, A Trump Tax Break to Help the Poor Went to a Rich GOP Donor's Superyacht Marina*, PROPUBLICA (Nov. 14, 2019), https://www.propublica.org/article/superyacht-marina-west-palm-beach-opportunity-zone-trump-tax-break-to-help-the-poor-went-to-a-rich-gop-donor (reporting that Wayne Huizenga Jr., owner of West Palm Beach Rybovich superyacht marina and son of billionaire Wayne Huizenga Sr., successfully appealed directly to then-governor Rick Scott to have the census tract encapsulating the marina nominated as an Opportunity Zone, as he long planned building luxury apartments there) [perma.cc/XH2U-BXW2]; Letter from H. Wayne Huizenga, Jr. to Governor Rick Scott (Apr. 10, 2018), available at https://assets.documentcloud.org/documents/6531609/Rybovich-Support-Ltr-WPB-Opportunity-Zones.pdf (writing to submit three eligible census tracts as Opportunity Zones "in order to take advantage of the significant private sector investment . . . poised to take place" and noting that a $120 million residential building, that incorporates the Rybovich marina, has been planned for some time).

37. *See* Dan Alexander & Chase Peterson-Withorn, *More than 25 Billionaires Poured Millions Into Trump's Inaugural Committee*, FORBES (Apr. 19, 2017), https://www.forbes.com/sites/danalexander/2017/04/19/more-than-25-billionaires-poured-millions-into-trumps-inaugural-committee/#3bc9c1a3cb33 (detailing who several of the greatest contributions to the Trump campaign and inauguration came from, many of whom are close friends of the President) [perma.cc/L3ZG-8KUU].

38. *Id.*

39. *See* Drucker & Lipton, *supra* note 33, at 19 ("The tax break is largely benefiting the real estate industry—where Mr. Trump made his fortune and still has extensive business interests—and it is luring people with personal or professional connections to the president.").

an Opportunity Zone in 2018, and the Treasury Department has since made the designation official.[40] It is these types of lobbying practices and the designations that result from them that need to be regulated more closely.

Since the Tax Cuts and Jobs Act legislation of 2017 was enacted, additional guidance on section 1400Z is needed. In December 2019, the Department of Treasury issued final regulations providing guidance for taxpayers who may elect the federal income tax benefits provided by section 1400Z-2.[41] This was followed by a series of proposed regulations related to QOFs and a notice and comment process that included public hearings.[42] While the final regulations clarify certain logistics such as the timing of investing and treatment of eligible gains, they do not provide any additional requirements or clarity regarding what kind of businesses or investment vehicles should be used or a requirement that local residents be employed in the expansion or creation of such businesses.[43] Taxpayers are currently able to move forward with the investments, but the question remains whether the incentives will benefit affected areas and their residents in the long term.[44]

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40. *See id.* (detailing that along with Richard LeFrak, among those who have invested or intend to are Steve Case, co-founder of AOL; Chris Christie, a one-time adviser to trump and former governor of New Jersey; and Cadre, an investment company co-founded by Jared Kushner, Donald Trump's son-in-law).

41. *See generally* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1,866 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (explaining the regulation governs "the extent to which taxpayers may elect the Federal income tax benefits provided by section 1400Z-2 of the Internal Revenue Code with respect to certain equity interests in a qualified opportunity fund".).

42. *See* REGULATIONS.GOV, *29 Search Results for qualified opportunity funds,* https://www.regulations.gov/searchResults?rpp=25&po=0&s=%22qualified%2Bopportunity%2Bfunds%22&fp=true&ns=true (listing 29 results for legislation activity related to qualified opportunity funds) [perma.cc/W8NH-EXRH].

43. *See id.* (providing additional incentives for investors to roll capital gains into Opportunity Zones without creating requirements for employment or education purposes).

44. *See* Angeline Rice & David Sobochan, *IRS Issues Second Set of Proposed Regulations on Opportunity Zones*, THE TAX ADVISER (Aug. 1, 2019), https://www.thetaxadviser.com/issues/2019/aug/irs-regs-opportunity-zones.html (providing clarity as to the additional regulations that were issued, none of which addressed socioeconomic concerns, and noting that many questions remained unanswered) [perma.cc/4S7M-4XZZ].

This Note proposes additional regulations on Opportunity Zones, including greater state regulation. It proposes that the types of investments allowed in designated Opportunity Zones should be limited in order to prevent the program from serving as a legislative loophole that provides a vehicle for wealthy investors to defer tax payments on investments that are already receiving preferential treatment. Instead, the investments in those areas should be serving the members of the community whom the regulations were initially designed to benefit.

Part II of this Note provides a background on income and wealth disparity in America, how capital gains tax rates promote investment, and the role these preferential tax rates play in the Opportunity Zone legislation. It also explains the process by which areas are nominated and designated as Opportunity Zones.

Part III explores concerns with the Opportunity Zone programs. It describes the way that the legislation favors America's wealthiest investors by outlining problematic ways in which some individuals are gaming the program to their advantage to become even wealthier. Part III also analogizes the Opportunity Zone program to the previously enacted New Markets Tax Incentive and Empowerment Zone programs and explores the ways in which Opportunity Zones may have a similar outcome and effect on economically distressed areas.

Part IV discusses the detrimental consequences residents and businesses in low-income areas may face as a result of the Opportunity Zone program. It details how investors funneling money into already affluent areas will not benefit the intended beneficiaries of the initiative and could instead do the exact opposite of its stated mission.

Part V suggests how administrative change at the state level could benefit the intended beneficiaries of Opportunity Zones by altering the kinds of investments that should be permitted. It provides examples from various states that have already adopted changes in light of the regulations and suggests that residents of the designated tracts be prioritized by the program's regulatory structure and given opportunities for employment in the creation and expansion of investment businesses. It further analogizes changes made following the New Markets Tax Incentive and Empowerment Zone programs, which were beneficial to low-income communities and suggests how supplementary

Opportunity Zone regulations should be crafted in a similar manner. If implemented, the changes suggested in Part V could benefit the intended beneficiaries of the Opportunity Zone legislation, lift low-income areas and residents out of poverty, create jobs, and help address the wealth and income disparity present in the United States.

II. Background

A. How Tax Policies Can Further Income Inequality in America

Income includes revenue streams from wages, salaries, interest on savings accounts, dividends from shares of stock, rent, and profits from selling goods at a higher price than they were purchased for.[45] Income inequality refers to the extreme disparity of income distributions, with a high concentration of income usually in the hands of a small percentage of a population.[46] The United States has the highest rate of income inequality of all Western countries.[47] The U.N. Human Rights Council Report of the Special Rapporteur reported that:

> The United States has one of the highest poverty and inequality levels among the OECD countries, and the Stanford Center on Inequality and Poverty ranks it 18th out of 21 wealthy countries in terms of labour markets, poverty rates, safety nets, wealth inequality and economic mobility. But in 2018 the United States had over 25 per cent of the world's 2,208 billionaires. There is thus a dramatic contrast between the immense wealth of the few and the squalor and deprivation in which vast

45. *See Income Inequality in the United States*, INST. FOR POL'Y STUD. https://inequality.org/facts/income-inequality/#income-inequality (last visited Nov. 26, 2020) (defining income and providing an overview of the disparity between those earners in the top 1% income tax bracket and the rest of the population in the United States) [perma.cc/3VFZ-8A9Z].

46. *See id.* (providing an overview of the disparity between those earners in the top 1% income tax bracket and the rest of the population in the United States).

47. *See* U.N. Secretariat, Philip Alston (Special Rapporteur on Extreme Poverty and Human Rights on his Mission to the United States of America) Hum. Rts. Council, U.N. Doc. A/HRC/38/33/Add.1 at 4 (May 4, 2018) (reporting further that the $1.5 trillion in tax cuts in December 2017 "overwhelmingly benefited the wealthy and worsened inequality").

numbers of Americans exist.[48]

Income inequality fuels a related phenomenon: Wealth inequality.[49] Wealth is measured by the difference in the value of a household or individual's assets and liabilities (assets being things a family owns—financial and nonfinancial—such as bank accounts, stocks, real estate, cars, or homes).[50] Liabilities, on the other hand, are debts which include mortgages, credit card balances, and other loans.[51] Wealth is significantly concentrated in the top 1% of the population—between 1989 and 2016 the wealth share of the top 1% of the population increased from about 30% to about 40%.[52] "Put a different way, a family at the 95th percentile of the wealth distribution had *twenty-three* times the wealth of a family at the middle, who in turn had more than nine times that of families at the 25th percentile."[53]

While for the vast majority of Americans income derives from wages, salaries, and other forms of labor compensation, the ultra-rich are the exception to this norm.[54] For households that

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48. *Id.*

49. *See* BRIAN KEELEY, OECD INSIGHTS, INCOME INEQUALITY: THE GAP BETWEEN RICH AND POOR 71 (2015) ("Rising inequality may also skew an economy in ways that reduce overall middle-class demand for consumer goods or even fuel debt crises. For example, high earners may have a lot of surplus wealth that they need to find ways to invest.").

50. *See* Greg Leiserson, Will McGrew & Raksha Kopparam, *The Distribution of Wealth in the United States and Implications for a Net Worth Tax*, WASH. CTR. FOR EQUITABLE GROWTH (Mar. 21, 2019), https://equitablegrowth.org/the-distribution-of-wealth-in-the-united-states-and-implications-for-a-net-worth-tax/ ("The high level of wealth inequality in the United States also is reflected in the substantial difference between median wealth ($97,000) and mean wealth ($690,000).") [perma.cc/JUW7-9H6B].

51. *See id.* (defining liabilities and explaining that the growing disparity in wealth and income inequality has "spurred increased interest in policy instruments that can combat inequality").

52. *Id.*

53. *See* Fabian T. Pfeffer & Robert F. Schoeni, *How Wealth Inequality Shapes Our Future*, 2 RSF: THE RUSSELL SAGE FOUND. J. OF THE SOC. SCI., no. 6, 2016, at 10 (emphasis added) (detailing how wealth distributions have changed in American households between the years 1984 and 2015 and reporting that median wealth in 2013 was $81,400 and 12.9% of households had no wealth or were in debt).

54. *See* Philip Stallworth, "*Let Me Tell You About the Very Rich. They are Different from You and Me.*", TAX POL'Y CTR. URB. INST. & BROOKINGS INST. (Mar. 18. 2019), https://www.taxpolicycenter.org/taxvox/let-me-tell-you-about-very-rich-they-are-different-you-and-me (reporting that those who fall within the

make $25,000 or less per year, labor income accounts for approximately 50% of total income, and government assistance accounts for approximately one third.[55] For the remaining income groups, 60% or more of yearly income is accounted for by wages, salaries, and employment-related benefits.[56] For those who make up the top 0.1%, (those earning an annual income of $3.4 million or more), more than 50% of household income is derived from interest, dividends, and capital gains while *only 25%* of income is derived from wages and benefits.[57]

In 2016, 80.4% of the wealth of the top 1% consisted of financial assets such as corporate stock, financial securities, mutual funds, interests in personal trusts, and ownership interests in unincorporated businesses.[58] Yet, only 7% of people in the United States reported taxable capital gains, with nearly two-thirds of that income being reported by people with a total annual household income of $1 million or more.[59] At the same time, the United States struggles with extreme poverty and commentators note that this poverty persists in part due to policy design choices.[60] "At the end of the day, however, particularly in a

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exception to this norm are the highest 1% income earners, those who make $783,000 or more annually and whose income is split equally between income derived from capital and labor) [perma.cc/ZQY2-7YL8].

55. *See id.* ("These differences in sources of income matters for policymakers hoping to use the tax code to reduce income inequality.").

56. *See id.* (noting that this data is depictive of the shares of income sources within each income group, not how specific individuals within the groups actually earn their income).

57. *See id.* (emphasis added) (describing how the top 0.1% earn most of their annual income from sources that receive preferential tax treatment, resulting in a smaller proportion of earnings being paid in taxes than if all of their income was derived from wages).

58. *See* Alexandra Thornton & Galen Hendricks, *Ending Special Tax Treatment for the Very Wealthy*, CTR. FOR AM. PROGRESS (June 4, 2019, 12:01 AM), https://www.americanprogress.org/issues/economy/reports/2019/06/04/470621/ending-special-tax-treatment-wealthy/ (explaining that the disparities in income are dwarfed by disparities in wealth and that the value of such financial assets has grown significantly over time) [perma.cc/3YZZ-TPNX].

59. *See* Drucker & Lipton, *supra* note 33, at 18 ("Yet this is a vital constituency, since the success of the Opportunity Zone program will hinge largely on how much money investors kick in.").

60. *See* Alston, *supra* note 47, at 4

> For almost five decades the overall policy response has been neglectful at best, but the policies pursued over the past year seem deliberately

rich country like the United States, the persistence of extreme poverty is a political choice made by those in power."[61]

Trends in the United States tax regime suggest that tax policy has been geared toward enabling the small percentage of extremely wealthy Americans to become even wealthier.[62] Structural changes in the tax code favoring wealthy individuals occurred over the same period of time that income and wealth inequality grew.[63] In the late 1980s, the top marginal income tax rate dropped well below 50% and today stands at 37%.[64] The Tax Cuts and Jobs Act, enacted in December 2017, was a boon to wealthy Americans despite receiving public opposition to the tax cuts for the wealthy.[65] Today, a person who earns $650,000 pays the same top marginal tax rate as one who earns $10 million, but this has not always been the case.[66] For decades following the

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> designed to remove basic protections from the poorest, punish those who are not in employment and make even basic health care into a privilege to be earned rather than a right of citizenship.

61. *Id.*

62. *See* Warren E. Buffett, Opinion, *Stop Coddling the Super-Rich*, N.Y. TIMES, Aug. 14, 2011, at 21 ("[W]hile most Americans struggle to make ends meet, we mega-rich continue to get our extraordinary tax breaks. These and other blessings are showered upon us by legislators in Washington who feel compelled to protect us . . . . It's nice to have friends in high places").

63. *See* Thornton & Hendricks, *supra* note 58 (providing an overview of how the United States' tax policy favors the extremely wealthy and ways in which this can be corrected to close the wealth gap).

64. *See Historical Highest Marginal Income Tax Rates*, TAX POL'Y CTR. URB. INST. & BROOKINGS INST. (Feb. 4, 2020), https://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates (delineating the top marginal personal income tax rates from 1913–2020) [perma.cc/2M8Z-KYME].

65. *See* Wilson Andrews & Alicia Parlapiano, *What's in the Final Republican Tax Bill*, N.Y. TIMES https://www.nytimes.com/interactive/2017/12/15/us/politics/final-republican-tax-bill-cuts.html (last updated Dec. 18, 2017) (explaining that the bill cut taxes for corporations, lowered individual tax rates until 2025, but would result in a tax increase over the long run long after the cuts expire) [perma.cc/RV8C-FPJ9]; *see also Trump, Republicans' Tax Reform Law*, REALCLEAR POLS., https://www.realclearpolitics.com/epolls/other/trump_republicans_tax_reform_law-6446.html#polls (last visited on Nov. 27, 2020) (showing that news outlets reported that a majority of the public opposed the Tax Cuts and Jobs Act's reform to lower the rates on extreme wealth) [perma.cc/9S3B-YBM5].

66. *See Federal Individual Income Tax Rates History, Income Years 1913–2013*, https://files.taxfoundation.org/legacy/docs/fed_individual_rate_history_nominal.

enactment of the income tax in 1913, the highest top marginal income tax rate in the United States was typically 50% or higher.[67] In fact, for more than four decades, the top tax rate was 70% or higher; with the highest rate being 94% for those earning $200,000 or more annually in the years 1944 and 1945.[68]

B. Capital Gains Advantages

The tax rate treatment of long-term capital gains, which includes investments in Opportunity Zones, exacerbates the wealth disparity.[69] The lower rates on long-term capital gains have existed in varying forms since the 1930s; largely as a result of the country's most wealthy utilizing their wealth—e.g., by making donations to candidates—to influence the political system and lobby for tax incentives that would place them at an advantage.[70] Those in the highest wealth thresholds would normally be taxed at the highest ordinary income tax rate applicable, which is 37%.[71] Instead, because they receive most of their compensation in the form of capital gains, they are taxed at a significantly lower rate—

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pdf (last visited Nov. 27, 2020) (reporting that in 1917 those earning $650,000 annually were subject to a marginal tax rate of 54% while those earning $2,000,000 and more were subject to the highest marginal tax rate of 67%); *see also* Grant Suneson, *From AMC Networks's Josh Sapan to Broadcom's Hock Tan: These are the Highest Paid CEOs of 2018*, USA TODAY, https://www.usatoday.com/story/money/2018/12/21/highest-paid-ceos-2018/38756663/ (last updated Dec. 21, 2018, 7:18 AM) ("Top-performing—and sometimes less than top-performing—CEOs are rewarded with lucrative contracts that generally include salary, bonuses, stock and options grants, and benefits. In a few cases, CEOs are set to earn more than $100 million in total compensation in 2018.") [perma.cc/B72D-AYGK].

67. *See generally Federal Individual Income Tax Rates History, Income Years 1913–2013, supra* note 66.

68. *Id.*

69. *See* Buffet, *supra* note 62, at 21 (describing how if you make money with money, as Buffet's "super-rich" friends do by investing, you pay practically nothing in payroll taxes and only a 15% rate on most of your earnings, but if you earn money from a job, your percentage will exceed Buffet's—"most likely by a lot").

70. *See id.* ("[L]egislators in Washington . . . feel compelled to protect us, much as if we were spotted owls or some other endangered species.").

71. *See* I.R.C. § 1(j)(2) (providing the current rates that are set to expire after December 31, 2025).

the highest since 2012 being 20%.[72] The very wealthy hold most of the financial assets in the United States and law makers have admitted that in part the legislation was motivated by the desire to satisfy those wealthy individuals who are also active political donors.[73]

Capital gains are profits made from the sale of a capital asset and are classified as either short-term or long-term.[74] In order to determine whether a taxpayer has a capital gain or loss, he or she must first know their cost basis in that investment.[75] A capital gain is generally triggered by the sale or exchange of an investment.[76] Capital gains or losses refer to the increase or decrease in the value of an asset between the time of its purchase and the time it is

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72. *See* Sean Williams, *A 95-Year History of Maximum Capital Gains Tax Rates in 1 Chart*, THE MOTLEY FOOL, https://www.fool.com/retirement/2017/02/11/a-95-year-history-of-maximum-capital-gains-tax-rat.aspx (last updated May, 30, 2018, 4:15 PM) ("With the exception of pre-1941 and 2004–2012, maximum capital gains tax rates have regularly been 20% or higher. . . . The current rate of 20% is actually low compared to where things have been since 1941 . . . .") [perma.cc/QZD4-XUHJ].

73. *See* Harry Enten, *The GOP Tax Cuts Are Even More Unpopular Than Past Tax Hike*s, FIVETHIRTYEIGHT (Nov. 29, 2017, 11:15 AM), https://fivethirtyeight.com/features/the-gop-tax-cuts-are-even-more-unpopular-than-past-tax-hikes/ (reporting that many Americans were opposed to the GOP tax cuts because they believe it disproportionately benefits the rich and that the GOP bill is one of the least popular tax plans since Ronald Reagan's day) [perma.cc/2Y5U-MG7Q].

74. *See* I.R.S., *supra* note 20 (providing examples of capital assets including a home, personal-use items like household furnishings, and stocks or bonds held as investments); *see also Key Elements of the U.S. Tax System*, TAX POL'Y CTR. URB. INST. & BROOKINGS INST., https://www.taxpolicycenter.org/briefing-book/how-are-capital-gains-taxed

(last updated May 2020) (providing background information regarding what qualifies as a capital gain and how capital gains are currently taxed under the Tax Cuts and Jobs Act of 2017) [perma.cc/KKM5-4XXG]; *see also* I.R.C. § 1221 (2018) (defining long-term and short-term capital gains).

75. *See* Kaitlyn Kiernan, *Capital Gains Explained*, FINRA (Sept. 19, 2017), https://www.finra.org/investors/insights/capital-gains-explained ("For stocks and bonds, the basis is generally the price you paid to purchase the securities, including purchases made by reinvestment of dividends or capital gains distributions, plus other costs such as the commission or other fees you may have paid to complete the transaction.") [perma.cc/4KK3-YWZ2].

76. *See id.* (explaining that your capital gain or loss is the difference between the sale price of your investment and the basis); *see also* I.R.C. § 1222 (defining short-term and long-term capital gains).

sold.[77] This applies to the sale of any capital asset including stocks, bonds, and real estate.[78] Currently, depending on the taxpayer's income, his or her long-term capital gain tax rate can be anywhere from 0% to 20%.[79]

Once an asset is sold or transferred to another person or entity, a realization event occurs, triggering recognition of the gain.[80] The wealthy are able to be more flexible in their ability to hold on to capital assets indefinitely, thereby shielding themselves from taxation as their assets grow in value.[81] The timing of when these individuals realize the income is largely in their control, insofar as they can decide when or whether to sell their assets and take advantage of tax deferral.[82] Further, this timing control can include the decision by the taxpayer to hold the asset until death, which results in another preference: A step-up in basis to heirs who inherit the property.[83]

Most Americans are not given stock options as a part of their compensation packages, and many cannot afford to invest in stocks or purchase real estate for the sole purpose of holding the property as an investment.[84] "While most middle-class Americans own

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77. *See* Erica York, *An Overview of Capital Gains Taxes*, TAX FOUND. (Apr. 16, 2019), https://taxfoundation.org/capital-gains-taxes/ (explaining that when a capital asset is sold for a profit, the seller faces a tax on the gain that they realized and the tax rate applicable to the gain will depend on how long the asset was held and the amount of income the taxpayer earns) [perma.cc/87WV-4698].

78. *Id.*

79. I.R.C. § 1(h) (2018) (providing the range of tax rates applicable to capital gains).

80. *See* I.R.C. § 1001(c) (2018) (mandating that whatever gain is realized from dealings in property must be included in gross income unless an exception applies).

81. *See* GOLDMAN SACHS, *supra* note 13, at 13 (explaining how deferring taxes allows for the accumulation and preservation of wealth as this allows investment returns to compound over time and can lead to higher long-term returns).

82. *Id.*

83. *See* I.R.C. § 1014 (providing the basis of property rules when acquired by a decedent).

84. *See* Lydia Saad, *What Percentage of Americans Owns Stock?*, GALLUP, https://news.gallup.com/poll/266807/percentage-americans-owns-stock.aspx (last updated June 4, 2020) (finding that in 2020, 55% of Americans reported owning stock, including individual stocks they may own, as well as stocks included in mutual funds or retirement savings accounts such as a 401(k) or IRA) [perma.cc/6DP5-PAE2].

stocks or bonds, they tend to stash them in tax-sheltered retirement accounts, where the capital gains rate does not apply."[85] Advocates for low capital gains tax rates claim that it spurs more investment in the economy, which benefits all Americans.[86] Over the last twenty years, however, more than 80% of the capital gains income realized in the United States has gone to only 5% of the population.[87] The 400 richest taxpayers in 2008 counted 60% of their income in the form of capital gains and 8% from salary and wages—the rest of the country reported 5% in capital gains and 72% in salary and wages.[88]

Despite all of this, preferential tax treatment of capital gains has its own benefits and is generally looked upon favorably.[89] Lower rates on capital gains encourages investments in capital assets, and investments are key for long-term growth.[90] Low capital gains tax rates also promote selling assets and prevent the so-called "lock-in effect," which results when investors who would normally sell assets keep them indefinitely in order to avoid taxation.[91] Proponents of the preferential rates on capital gains

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85. Steven Mufson & Jia Lynn Yang, *Capital Gains Tax Rates Benefiting Wealthy are Protected by Both Parties*, WASH. POST (Feb. 12, 2020, 5:08 PM), https://www.washingtonpost.com/business/economy/capital-gains-tax-rates-benefiting-wealthy-are-protected-by-both-parties/2011/09/06/gIQAdJmSLK_story.html [perma.cc/4KS2-FDYS].

86. *See What is the Effect of a Lower Tax Rate for Capital Gains?*, TAX POL'Y CTR. URB. INST. & BROOKINGS INST., https://www.taxpolicycenter.org/briefing-book/what-effect-lower-tax-rate-capital-gains#:~:text=By%20reducing%20the%20disincentive%20to,leading%20to%20higher%20economic%20growth.&text=Even%20without%20a%20tax%20preference,after%2Dtax%20variance%20of%20returns. (last updated May 2020) ("By reducing the disincentive to invest, a lower capital gains tax rate might encourage more investment, leading to higher economic growth.") [perma.cc/GUZ8-LXG5].

87. Mufson & Yang, *supra* note 85 ("Approximately 50 percent of all capital gains have gone to the wealthiest 0.1%.").

88. *See id.* ("The way you get rich in this world is not by working hard," said Marty Sullivan, an economist and a contributing editor to Tax Analysts. "It's by owning large amounts of assets and having those things appreciate in value.").

89. *See The Tax Break-Down: Preferential Rates on Capital Gains*, COMM. FOR A RESPONSIBLE FED. BUDGET (Aug. 27, 2013), http://www.crfb.org/blogs/tax-break-down-preferential-rates-capital-gains (covering arguments both for and against lower rates on capital gains) [perma.cc/QPB5-YS7U].

90. *Id.* ("The value of the capital gains tax preference is significantly higher than the potential revenue raised from eliminating it.").

91. *See id.* (explaining that estimating agencies have predicted that the lock-in effect is so severe that taxing capital gains as ordinary income could result

also argue that the lower capital gains tax offsets the taxes that are already paid at the corporate level, encourages risk taking and entrepreneurship, offsets the effects of inflation, and mitigates the tax penalty on savings under the income tax.[92] That being said, some commentators express concern that when capital gains are used in the manner that they are with Opportunity Zones, the negatives outweigh the positives.[93]

C. Direct Versus Indirect Tax Subsidies

Under the tax expenditure theory, investment tax incentives can be understood as "tax subsidies" used to promote investments—in practice, special provisions are written into a federal tax system in order to achieve non-tax related social and economic goals.[94] Tax scholar Michelle Layser, who has written about Opportunity Zones, notes that the choice between a tax incentive as an indirect or direct subsidy "can have important implications for the effectiveness of the tax incentives as anti-poverty tools."[95]

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in a loss of revenue relative to the current tax regime).

92. *See* TAX POL'Y CTR. URB. INST. & BROOKINGS INST., *supra* note 86 (comparing the top tax rates on long term capital gains with real economic growth from the years 1954 to 2017 and concluding that "the tax rate on capital gains does not appear to be a major factor").

93. *See* Darla Mercado, *Advisors Must Weigh Benefits and Real Dangers Before Offering this Hot New Tax Play*, CNBC, https://www.cnbc.com/2019/05/27/advisors-must-assess-risk-and-rewards-of-opportunity-zone-funds.html (last updated May 28, 2019, 8:44 AM) (advising investors to do their due diligence before investing in Opportunity Zones) [perma.cc/H32T-6HM8].

94. *See* Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 706 (1970) (explaining that these provisions could take the form of "deductions, credits, exclusions, exemptions, deferrals, preferential rates, and serve ends similar in nature to those served by direct government expenditures or loan programs").

95. *See* Michelle D. Layser, *A Typology of Place-Based Investment Tax Incentives*, 25 WASH. & LEE J. CIV. RTS. & SOC. JUST. 403, 415 (2019) (providing a comparison of direct and indirect tax subsidies and how they affect "the types of claimants and transactions motivated by the tax incentives").

1. Direct Tax Subsidies

Direct tax subsidies provide tax breaks directly to businesses that operate in low-income communities.[96] These tax incentives are claimed directly by eligible businesses, which lawmakers designate as eligible for the tax incentive.[97] The businesses then have incentives to perform certain activities in low-income areas.[98]

2. Indirect Tax Subsidies

Indirect tax subsidies are those that target third-party investors as claimants, the ultimate goal being to subsidize businesses that engage with low-income communities.[99] Indirect tax subsidies create incentives for investors to make capital contributions to businesses in low-income areas.[100] They differ from direct subsidies in that investors are able to freely choose which eligible projects to fund.[101]

Opportunity Zone legislation is an indirect tax subsidy because it targets investors rather than businesses.[102] Taxpayers who sell appreciated property can defer or permanently avoid taxes they would otherwise owe on the capital gains by reinvesting the capital gains in Opportunity Funds.[103]

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96. *Id.* (citing COLO. REV. STAT. § 39-90-105.1 (2016)).

97. *See id.* ("Stated simply, direct tax subsidies make it cheaper for eligible taxpayers to do business.").

98. *See id.* at 418 (including activities such as "starting or expanding a business, or hiring certain employees").

99. *See id.* at 417–18 (contrasting direct tax subsidies with indirect tax subsidies and the incentives that indirect tax subsidies provide to investors).

100. *Id.* at 418.

101. *See id.* ("By subsidizing the investments, these tax laws decrease the cost of capital for businesses that engage with low-income communities, and generally increase the availability of financing.").

102. *See generally* Layser, *supra* note 95 (providing a comparison of direct and indirect tax subsidies and how they affect "the types of claimants and transactions motivated by the tax incentives").

103. *Compare* I.R.C. § 1400Z-2(b)(2)(B) (2018) (providing the tax deferrals available to taxpayers who invest in Opportunity Zones for five or seven years), *and* I.R.C § 1400Z-2(c) (2018) (providing the tax deferrals available to taxpayers who invest in Opportunity Zones for ten years), *with* I.R.C. § 1(h) (2018) (providing the preferential rates for capital gains generally).

D. Nomination and Designation of Opportunity Zones

Opportunity Zones now exist in all fifty states, the District of Columbia, and five U.S. territories.[104] Opportunity Zones are "economically-distressed communities where new investments, under certain conditions, may be eligible for preferential tax treatment."[105] Each state's governor has the opportunity to nominate up to 25% of the state's eligible census tracts—for example, if a state has 500 low-income census tracts, 125 may be designated as Opportunity Zones.[106] The nominated blocks of low-income areas by census tract are then certified by the U.S. Secretary of the Treasury.[107]

Many tracts are nominated after being lobbied for by development groups or individual investors.[108] For example, this Note previously mentioned Richard LeFrak, the businessman, real estate developer, and personal friend of Donald Trump who had executives encourage city officials to nominate North Miami as an Opportunity Zone.[109] Similarly, the Far West Side of Manhattan is part of an Opportunity Zone, despite the fact that more than 15% of households there reported a household income of $200,000 or more in 2017.[110] Because the law does not require disclosure of who is taking advantage of the initiative or how they are deploying

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104. *See Opportunity Zones Frequently Asked Questions*, I.R.S., https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions (last updated Dec. 15, 2020) (answering frequently asked questions regarding the new Opportunity Zone legislation) [perma.cc/Y3UC-S5YU].

105. *Id.*

106. *See Opportunity Zones: A New Economic Development Tool for Low-Income Communities, Guidance for Governors*, ECON. INNOVATION GRP. (Feb. 2018) (briefing on the role that governors play in the implementation of the Opportunity Zone program).

107. *See id.* (explaining that after submission, the Treasury Secretary has 30 days to certify the state's Opportunity Zones).

108. *See* Elliot, *supra* note 36 ("The Trump tax law gave governors the authority to distribute valuable tax breaks, and they have wielded it to benefit the politically connected.").

109. *See* Drucker & Lipton, *supra* note 33 (reporting that LeFrak had this area nominated for a project called Sole Mia—set to include twelve residential towers and eight football fields' worth of retail and commercial space).

110. *See id.* (describing how high-end towers were replacing run-down apartment buildings in Manhattan even before the Opportunity Zone legislation was enacted).

their funds, investors are able to finance luxury hotels with this tax-advantaged money—driving money into areas that are already on the rise, not those that are struggling.[111]

The lack of disclosure requirement leads to instances in which city officials are unaware that an opportunity-zone project is even being planned.[112] Perhaps if city officials were involved in vetting the types of investments that are being made, they could achieve the goal of benefitting these poor areas.

1. Life Cycle of an Opportunity Zone

Investors first file a Form 8996, to notify the IRS of the creation of a Qualified Opportunity Fund (QOF)—generally, in the form of a vehicle structured as either a partnership or corporation and organized for the purpose of investing in an Opportunity Zone.[113] In order to invest in the QOF, a taxpayer must sell a capital asset, generate a capital gain, and reinvest that unrealized capital gain into a QOF within 180 days of the sale.[114]

A taxpayer then reinvests short or long term capital gains from a prior investment, within 180 days, into a QOF and defers taxes on the gain for the year of sale → the QOF conducts a

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111. *See id.* (reporting that the Warehouse District of New Orleans, a very trendy area, has been designated as an Opportunity Zone and will benefit Richard Branson's Virgin Hotels chain, unveiled one year before the legislation was announced—investors will now earn greater profits than they otherwise would have).

112. *See id.* (stating that the head of economic development for New Orleans was unaware of the Branson Hotel being planned less than two miles away from one of the poorest Opportunity Zones in Louisiana and the nation, the Hoffman Triangle neighborhood, where the average household earns less than $15,000 annually).

113. *See* Morgan Simon, *What You Need to Know About Opportunity Zones*, FORBES (Mar. 30, 2019, 4:03 PM), https://www.forbes.com/sites/morgansimon/2019/03/30/what-you-need-to-know-about-opportunity-zones/#63a4abb56ae2 (providing guidelines and outlining the mechanisms and logistics to investing in an Opportunity Zone) [perma.cc/MP9G-GYNS]; *see also* Instructions for Form 8996, Qualified Opportunity Fund, I.R.S. (Jan. 2020), https://www.irs.gov/pub/irs-pdf/i8996.pdf.

114. *See* Jacoby, *supra* note 30 ("Because taxpayers must have unrealized capital gains to invest in an Opportunity Zone, and capital gains are heavily concentrated among the wealthy, the tax break will directly benefit wealthy investors."); *see also* I.R.C. § 1400Z-2(a)(1)(A) (mandating the reinvestment take place within 180 days of the sale of the capital asset).

"Section 162 business,"[115] either directly by holding qualified Opportunity Zone business property (QOZBP) or indirectly by holding Opportunity Zone stock or an Opportunity Zone partnership interest, provided the subsidiary meets the definition of a qualified Opportunity Zone business (QOZB) → After holding the interest in the QOF for five years, the taxpayer will exclude 10% of the original deferred gain → After an additional two years, another 5% of the original deferred gain is excluded → Any remaining deferred gain will be recognized on December 31, 2026, unless an "inclusion event" occurs prior to that date → After holding the interest in the QOF for a total of ten years, the taxpayer may sell the investment in the QOF, or—in limited circumstances—the QOF or QOZB may sell its assets—at any time before 2048 and the taxpayer can exclude all—or most of—the gain resulting from the sale.[116]

For example, someone who buys stock for $100,000 and sells it more than one year later for $1.1 million would ordinarily have $1 million subject to the capital gains tax.[117] However, if the investor instead invested the $100,000 in an Opportunity Zone for five years, the original basis in the stock of $100,000, would be stepped up to $200,000.[118] It would be stepped up again to $250,000 if the investment was held on to for seven years.[119] The result of this tax benefit is that it reduces the amount of gain ultimately subject to taxation. Taxes on capital gains from investments in the qualified Opportunity Zones can be avoided all together, if held for

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115. *See* I.R.C. § 162 (2018) (providing deductions for business expenses); *see also* Commissioner v. Groetzinger, 480 U.S. 23, 35 (1987) (holding that in order "to be engaged in a trade or business the taxpayer must be involved in an activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit . . . . A sporadic activity, a hobby, or an amusement does not qualify").

116. *See* Tony Nitti, *IRS Publishes Final Opportunity Zone Regulations: Putting it All Together*, FORBES (Dec. 23, 2019, 9:11 AM), https://www.forbes.com/sites/anthonynitti/2019/12/23/irs-publishes-final-opportunity-zone-regulations-putting-it-all-together/#56dd9fe72551 (providing this life cycle and noting that a QOF must conduct business in an Opportunity Zone, either directly or indirectly, to be tested every six months at which time at least 90% of the QOF's assets must be QOZP or an interest in a subsidiary entity conducting a QOZB) [perma.cc/8NQL-TBVE].

117. I.R.C. § 1(h) (2018).

118. I.R.C. § 1400Z-2(b)(2)(B)(iii) (2018).

119. I.R.C. § 1400Z-2(b)(2)(B)(iv) (2018).

at least ten years.[120] This is an incredibly preferential benefit—the Economic Innovation Group calculated that this would result in a net after-tax profit of $7,600 on the initial $100,000 investment, compared to $3,600 if the original capital gain had been invested in a regular stock portfolio, assuming 7% annual return rates for both.[121]

E. Characteristics and Demographics of Opportunity Zones

"Opportunity Zone legislation is intended to seed new startups, accelerate business expansions, create jobs, increase and improve housing options, and revitalize the built environment in distressed communities across the country."[122] The intended recipients of all of these benefits are not only the investors, but the residents of these zones.[123] So, who are the residents of Opportunity Zones throughout the country? The majority of Opportunity Zone residents, 56%, are non-white minorities, compared to 39% of non-white minorities who make up the country as a whole.[124] Black Americans are particularly over-represented

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120. I.R.C. § 1400Z-2(c) (2018).

121. *See* Lydia Depillis, *A 'Mind Boggling' Tax Break was Meant to Help the Poor. But Trendy Areas are Winning Too*, CNN BUS., https://www.cnn.com/2019/06/14/economy/opportunity-zones-investing-los-angeles/index.html (last updated June 14, 2019, 8:32 AM) ("Looked at another way, if a stock market portfolio generated after-tax returns of about 2.8% per year, the Opportunity Zone incentive amounts to an extra 3 percentage points on top of that if held for 10 years, which can add up to a lot for larger deals.") [perma.cc/ESJ8-8C74].

122. *See Opportunity Zones*, ECON. INNOVATION GRP. (Jan. 2020), https://eig.org/opportunityzones/facts-and-figures ("How do Opportunity Zones work? Investors can now choose to roll capital gains over into qualified Opportunity Funds, which in turn channel patient capital into qualifying equity investments in Opportunity Zones for at least a decade in exchange for capital gains tax reductions and possible exemptions.") [perma.cc/8WNU-KDYJ].

123. *See id.* ("This new source of risk capital will seed new startups, accelerate business expansions, create jobs, increase and improve housing options, and revitalize the built environment in distressed communities across the country.") [perma.cc/8WNU-KDYJ].

124. *See* Kenan Fikri & John Lettieri, *The State of Socioeconomic Need and Community Change in Opportunity Zones*, ECON. INNOVATION GRP., 5, 7 (Dec. 2018) (outlining characteristics of the average Opportunity Zone—the Median Family Income of the median zone being $42,400, 40% below the national median of $67,900 or only three-fifths of the national level).

in Opportunity Zones, constituting twice as large a share of the zone population as they do the national population.[125] Hispanic Americans make up 18% of the general population and 26% of the Opportunity Zone population.[126]

In total, 7.9 million Americans residing in Opportunity Zones live in poverty—the average poverty rate in the zones being 27.7%, compared to a national poverty rate of 14.1%.[127] Three-fifths of zones have a Median Family Income (MFI) below $50,000 with only 6% of zones having a MFI greater than the national MFI.[128] There are more Opportunity Zones in the $40,000 to $42,500 range than there are above the national MFI of $73,965.[129] Within Opportunity Zones, 21.1% of adults do not have a high school diploma, and 18.1% of adults have a bachelor's degree or higher.[130]

While these statistics sound encouraging, as if Opportunity Zones are in fact targeting the most in need areas, the definition of "low-income community" is broad enough to include some areas that are not truly distressed.[131] Further problematic is the fact that the incentive does not include any requirements that the investments actually produce public benefits or that the Opportunity Zone investment businesses hire employees from residents of, or provide services to, the local community.[132]

III. Gaming the Opportunity Zone System

As highlighted in Part II of this Note, some of the tracts that have been designated Opportunity Zones are not low-income areas

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125. *See* ECON. INNOVATION GRP., *supra* note 122 (reporting that Black Americans represent 12% of the United States and 23% of the demographics in Opportunity Zones).

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *See* Jacoby, *supra* note 30 (explaining that some areas are "adjacent to elite colleges—for example, the University of Virginia and University of California at Berkeley, where a large concentration of students skews the income data").

132. *See id.* (highlighting that the program mechanics fail to specify rules that will provide benefits to local residents of zones).

at all.[133] Over 200 of the 8,800 designated Opportunity Zones are adjacent to poor areas but are not themselves considered low-income.[134] Moreover, the investments that many investors are making in the areas that are designated do not necessarily help low-income communities at all.[135] Current law does not require public disclosure of who is taking advantage of the initiative or how they are deploying their funds.[136] Many high profile investors had committed to funding projects before the legislation was announced, and will now receive substantial tax benefits for pouring money into areas they had already planned to invest in and profit from.[137] The investments they are making in luxury real estate and retailers will probably displace residents, as it is unlikely that they will be able to afford to live in such places if costs rise.[138] Critics are concerned that the bulk of Opportunity Zone money is going toward places that do not need the help, rather than poorer communities that could stand to benefit more.[139] "Local residents will benefit only to the extent that the tax break encourages new investments (not those that would have occurred

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133. *See* Drucker & Lipton, *supra* note 33 (discussing some of the most prominent and wealthy investors in Opportunity Zones and the ways in which they are using the investments as vehicles to benefit themselves).

134. *See id.* ("The idea was to enable governors to draw Opportunity Zones in ways that would include projects or businesses just outside poor census tracts, potentially creating jobs for low-income people.").

135. *Id.*

136. *See* Elliot, *supra* note 36 ("It's unclear how valuable the tax break could be, and the public may never know because the Trump law included no public reporting requirements.").

137. *See id.* (stating that Huizenga wrote that the luxury apartment towers were planned some time ago and once the legislation was announced, the tract they fall in was lobbied to be designated as an Opportunity Zone).

138. *See* Jim Tankersley, *Amazon's New York Home Qualifies as 'Distressed' under Federal Tax Law*, N.Y. TIMES (Nov. 14, 2018), https://www.nytimes.com/2018/11/14/us/politics/amazon-hq2-long-island-city.html (describing how Amazon's choice to open headquarters in an upscale area of Long Island City gives eager developers who, would have flocked to the area anyway, tax benefits of Opportunity Zones and whether this is a good use of public subsidies is a question that remains to be answered) [perma.cc/H56A-EUEG].

139. *See generally* Jacoby, *supra* note 30 ("[T]he tax break risks exacerbating the three main flaws of the 2017 tax law itself: it mainly benefits wealthy investors instead of workers and residents of distressed communities, reduces federal revenues and makes our long term fiscal challenges worse, and creates new opportunities for tax avoidance.").

anyway); creates jobs for residents, spurs the development of new, affordable housing; or creates broader economic improvements that reach local residents."[140]

In order to assess how the new legislation may ultimately affect the zones and their residents, scholars have looked to similarly enacted past programs and those outcomes.

A. New Markets Tax Credit Incentive

Similar to the Opportunity Zone program, the New Markets Tax Credit (NMTC) was established in 2000 and is an indirect tax incentive claimed by third parties who invest in entities that, in turn, invest in targeted places.[141] NMTCs provide federal tax credits for investors who make Qualified Equity Investments (QEIs) in Community Development Entities (CDEs).[142] CDEs then use the proceeds of the QEIs to make Qualified Low-Income Community Investments (QLICs).[143] The program provides a total tax credit[144] of 39% of the original amount invested in the CDE, applied over a seven-year period.[145]

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140. *Id.*

141. *See Introduction to the New Markets Tax Credit Program*, CMTY. DEV. FIN. INST. FUND, 7 (Sept. 15, 2020), https://www.cdfifund.gov/Documents/2020%20Introduction%20to%20the%20NMTC%20Program_%20FINAL.pdf (explaining that the NMTC program is jointly administered by the CDFI Fund and I.R.S. "to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers") [perma.cc/V28T-BDJX].

142. *See id.* at 16 (defining certified CDEs as a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in low-income communities and is certified as such by the CDFI Fund).

143. *See id.* at 8 (providing an example of a QLIC as business loans made in low-income communities).

144. *See* Troy Segal, *Tax Credit*, INVESTOPEDIA, https://www.investopedia.com/terms/t/taxcredit.asp (last updated May 25, 2020) (defining a tax credit as "an amount of money that taxpayers can subtract from taxes owed to their government," reducing the actual amount of tax owed and explaining that governments may grant a tax credit in order to promote a specific behavior) [perma.cc/TCF8-3EB5].

145. *See* CMTY. DEV. FIN. INST. FUND, *supra* note 141, at 9 (illustrating that the credit rate is 5% of the original investment amount in each of the first three years and 6% of the original investment amount in each of the final four years,

The NMTCs and Opportunity Zone legislation define low-income communities in the same way.[146] A significant difference between the Opportunity Zone and NMTC program is that Opportunity Zone investors choose the investments that they will make in Opportunity Zones themselves, while the Community Development Financial Institutions Fund (CDFI Fund) evaluates NMTC investments based on a competitive application process.[147] Opportunity Zones are tied to the previous ownership of capital gains and reinvesting prior gains, which makes it more difficult for non-profit programs to participate in the program.[148] NMTCs are not tied to ownership of capital gains, and loans to nonprofit organizations qualify for the initiative.[149] These differences in the programs appear to have led to very different types of projects being subsidized by the programs.[150] Researchers estimate that 26% of Opportunity Zone funding is likely to subsidize luxury, market rate apartments and condos, while 21% of NMTC investments will go toward education and only 12% will go toward apartments and condos.[151]

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amounting to 39% of the original amount invested in the CDE after seven years).

146. *See* I.R.C. § 45D(e) (2018) (defining low-income community under the NMTC); *see also* I.R.C. § 1400Z-1(c)(1) (2018) ("[T]he 'low income community' has the same meaning as when used in section 45D(e).").

147. *See* Michelle D. Layser, *How Place-Based Tax Incentives Can Reduce Geographic Inequality*, TAX L. REV. at 37 (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3516469# (CDEs that apply for NMTC allocations are "evaluated on factors such as whether a proposed grocery store would be located in a food desert, or whether a proposed medical facility would be located in a medically underserved area") [perma.cc/MNM6-TNRS].

148. *See* Jack Abdo, *Nonprofits: Leverage a Qualified Opportunity Zone Fund to Further Your Mission*, ABDO EICK & MEYERS LLP, https://aemcpas.com/nonprofits-leverage-a-qualified-opportunity-zone-fund-to-further-your-mission/ (suggesting non-profits partner with donors to acquire property in QOZs, donors could lease buildings nonprofits to get into the building at an affordable rate, then collect rent and plan to either sell or donate the building back to the nonprofit) [perma.cc/EH8M-3QHK].

149. *See* PowerPoint, Michelle Layser, Assistant Professor, Univ. of Ill. at Urbana Champaign, *Comparing Opportunity Zones to New Markets Tax Credit,* ABA Tax Section Annual Meeting (Jan. 2020) (on file with author).

150. *Id.*

151. *See id.* (reporting that 11% of Opportunity Zone funds will go toward office space potentially for tech startups that require high level of skill; 6% will go toward retail and restaurants and it remains to be seen what 39% of the investments will go toward).

According to the California Legislative Analyst's Office, NMTCs have "failed to deliver any measurable increase in the well beings of targeted communities."[152] It may be too early to assess Opportunity Zones' impact, but analysts suggest that "the Opportunity Zones statute and available agency guidance provide no reasons to expect the Opportunity Zones laws to benefit poor communities any more effectively than the NMTC. Instead, they include several reasons to expect the new laws to target poor communities even less closely than the NMTC."[153]

A lack of guidance as to the types of investments that should be made in Opportunity Zones, no requirements pertaining to job creation or "community-oriented activity," and the self-certification process for Opportunity Funds with little oversight are a few reasons why the "law's potential as an anti-poverty program is limited."[154]

B. Empowerment Zones

The federal Empowerment Zone program is one of the largest place-based tax incentive programs in the United States—implemented to encourage economic, physical, and social investment in the neediest urban areas of the country.[155] Empowerment zone designation provides two important benefits:

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152. *See* Alexander Ferrer & Joe Donlin, *Displacement Zones: How Opportunity Zones Turn Communities into Tax Shelters for the Rich* 9, STRATEGIC ACTIONS FOR A JUST ECON., https://www.saje.net/wp-content/uploads/2020/09/SAJE_DisplacementZones.pdf (noting that "while the program was popular with investors and successful in steering investment the program uniformly failed to improve the incomes of residents of zip codes receiving the funding") [perma.cc/VM64-46AQ].

153. *See* Layser, *supra* note 95, at 450 (explaining that one reason to expect the program to target poor communities poorly is that Opportunity Zone projects will probably be more clustered than NMTC projects which has been shown to have positive correlation with rent increase).

154. *Id.* at 451–52.

155. *See* Matias Busso, Jesse Gregory & Patrick Kline, *Results of the Federal Urban Empowerment Zone Program* 18, https://www.ssc.wisc.edu/~jmgregory/FOCUS_EZ_summary.pdf (stating that the first round of the program began in 1993, with the Department of Housing and Urban Development (HUD) assigning Empowerment Zone status to poor neighborhoods in six metropolitan areas: Atlanta, Baltimore, Chicago, Detroit, New York City, and Philadelphia-Camden) [perma.cc/75FC-DUNQ].

(1) It entitles local employers to a credit of up to 20% of the first $15,000 in wages paid to each employee who lived and worked in the community for up to ten years, with the maximum annual credit per employee declining over time and (2) each zone is eligible for $100 million in Social Service Block Grant funds.[156] "The Empowerment Zone subsidies stimulate the demand for labor and land in targeted areas."[157] For example, a firm that could profitably employ a local worker for $15,000 in the absence of the subsidy, can employ the same worker for $18,000 when offered a $3,000 employment tax credit.[158] Similarly, the block grants also give rise to increased wages.[159] However, "one 2010 study of the impact of the program in California found that it unequivocally failed to achieve its stated goal of increasing employment despite offering substantial benefits to businesses operating inside the zones."[160]

Opportunity Zones differ from both the NMTC and Empowerment Zone programs in that the incentives the legislation provides are far more valuable to investors and less restricted than these predecessors.[161] It applies to almost any type of project, requires no bureaucratic approval or monitoring, and has no cap.[162]

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156. *See id*. at 18 (explaining that the Social Service Block Grant funds could be used in a variety of ways such as business assistance, infrastructure investment, physical development, training programs, youth services, promotion of homeownership, and emergency housing assistance).

157. *Id*.

158. *See id*. (illustrating through example how this leads to increases in wages for employees and is effectively an income transfer to local workers).

159. *See id*. ("[M]aking local firms more productive through infrastructure investments and initiatives promoting safety and other local public goods. These productivity improvements should transfer into the wages of all zone workers whether they live in the zone or not.").

160. *See* Ferrer & Donlin, *supra* note 152, at 9 ("Other researchers noted that in the longest existing Empowerment Zone in the country the program not only failed to produce jobs in the originally designated area, but in fact jobs were lost, and that benefits flowed overwhelmingly to large corporations rather than small businesses.").

161. *See* Joseph Bateman, *How Do Opportunity Zones Differ from Existing Federal Tax Incentives for Community Development?*, SUMMIT LLC (Feb. 26, 2018, 8:51 AM), https://www.summitllc.us/blog/how-do-opportunity-zones-differ-from-existing-federal-tax-incentives-for-community-development (contrasting the fixed and limited amount of investment allowed by NMTCs each year with Opportunity Zones which require no such oversight which could "create the potential for the benefits of these investments to accrue primarily to investors . . . .") [perma.cc/KF7D-UE9G].

162. *See* Depillis*, supra* note 121 (comparing the Opportunity Zone program

IV. The Effect Opportunity Zones Have on Residents

Opportunity Zones are intended to be some of the poorest census tracts in the nation; however, residents of those poor neighborhoods are unlikely to benefit from or be able to afford rising real estate, which will most likely manifest in those communities as higher rent prices.[163] Homeownership levels are very low in Opportunity Zones, as most residents cannot afford to purchase homes and many of the homeowners who live in zones are cost burdened.[164] This threat to local residents' housing is potentially exacerbated by the requirements for property that can qualify as Opportunity Zone property.[165] The original use requirement of the legislation mandates that the asset in an Opportunity Zone has never been placed in service before.[166] Alternatively, the substantial improvement rule mandates that pre-existing assets within the zones be renovated or rebuilt so that the basis of the property is more than doubled by the improvements made to it after purchase by a QOF.[167] These requirements can lead to displacement, particularly in the substantial improvement scenario.[168] Whether the building is

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to the NMTC and Empowerment Zone program and highlighting that the Opportunity Zone investors are far less restricted in the types of investments they can make).

163. *See* Ferrer & Donlin, *supra* note 152, at 14 ("Competition with and between corporate investors limits homeownership opportunities for lower income families, and drives up rents and assesses irrational and burdensome fees as investors squeeze tenants for extra profit.").

164. *See id.* (rising prices of homes and land may push these residents out, rather than providing them with the financial benefits that come with rising home values—it may raise incentive for them to sell their homes and move to cheaper areas).

165. *See* I.R.C. § 1400Z-2 (d)(2)(D)(ii) (2018) (requiring that all property must be originally used or substantially improved in order to qualify).

166. *See id.* (same).

167. *See* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1, 866 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (clarifying that the land upon which a building is located is not required to be separately substantially improved, the requirement is only in regard to the original basis in the building).

168. *See* Ferrer & Donlin, *supra* note 152, at 14 (reporting that one community leader in South-Central Los Angeles described the Opportunity Zone requirements as what "seems like a slick way to undermine rent control").

rebuilt or renovated to double its value, the result is that many tenants will not be able to afford to return to the building.[169]

A. Gentrification

"Cities in the United States up and down the urban hierarchy have experienced significant levels of gentrification since the national economy emerged from the recession of the 1990s."[170] The introduction of the Opportunity Zone program threatens to accelerate this process within the designated tracts.[171]

1. The Case Study of Los Angeles

As of June 2019, the capital flowing into the Opportunity Zone program was just beginning and data were scarce, yet "anecdotal reporting suggests that Los Angeles is a microcosm of how the program is playing out nationally."[172] Luxury housing projects are already displacing long-term residents, most of whom are African Americans, in neighborhoods of Los Angeles like Crenshaw.[173]

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169. *See id.* (providing an example of a building with a value of $500,000 that must then be improved upon so that it is valued at $1,000,0001, in order to meet the § 1400Z-2 (d)(2)(D)(ii) requirements).

170. *See* Edward Goetz, *Gentrification in Black and White: The Racial Impact of Public Housing Demolition in American Cities*, URB. STUD. 1581 (June 2011), https://journals.sagepub.com/doi/pdf/10.1177/0042098010375323 ("Prominent among public-sector interventions has been the demolition of public housing and in some cases multimillion-dollar redevelopment efforts.") [perma.cc/83LC-K87X].

171. *See* Angela Peoples, *Opinion: Opportunity Zones are Just an Opportunity for the Rich to Gentrify Poor Neighborhoods*, MKT. WATCH (Oct. 29, 2019, 6:09 AM), https://www.marketwatch.com/story/opportunity-zones-are-just-an-opportunity-for-the-rich-to-gentrify-poor-neighborhoods-2019-10-29 (arguing that while the idea is for the new investment to create jobs, there are no requirements on what the investments look like and investors can "come in, build new housing developments or businesses that local residents can't afford, get their tax break, and leave") [perma.cc/BL24-NM4L].

172. *See* Depillis, *supra* note 121 (stating that investments are being funneled into areas like Los Angeles, Koreatown along with parts of Hollywood, Downtown, and the Arts District instead of places like Compton, where the median household income is $35,457, just above half of the national median).

173. *See id.* (describing how people who are interested in projects that are community-centered such as affordable housing, health care clinics, grocery stores, and businesses that employ local residents are scrambling for investor

The trends of neighborhood change and increased real estate prices are likely to continue accelerating generally, especially in cities like Los Angeles where there is already a heavy focus on real estate investment evident in existing QOFs.[174] For example, CIM group, one of the largest real estate developers in the country, created a $5 billion fund and "owns hundreds of Los Angeles properties including many commercial properties in the West Adams Corridor, which they plan to redevelop extensively."[175] HighBridge Properties created an opportunity fund it claims has a $50 million value to invest in off-campus student housing for California universities, which "could exacerbate already existing trends of gentrification and displacement near schools like the University of Southern California."[176]

Since the financial crisis of 2008, thousands of families have been forced to rent their homes from large institutions financed by Wall Street investment funds that bought homes being foreclosed on.[177] Wall Street investment funds' monopolizing rental markets

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attention as investors are drawn to the larger returns on their investments provided by luxury projects).

174. *See* Joseph Pimentel, *Businesses are Missing a Lucrative Part of Opportunity Zones, Experts Say*, BISNOW (Sept. 2, 2019), https://www.bisnow.com/feature/los-angeles-opportunity-zones/qualified-opportunity-zone-business-100559 (explaining that most investors are focused on the real estate investment side of the program and flipping commercial real estate in order to receive an investment return two to four times what they invested) [perma.cc/QG4V-C7N8].

175. *See* Ferrer & Donlin, *supra* note 152, at 13 (focusing on funding multi-family housing developments and the substantial improvement rule together threaten rent stabilized housing as well as affordable housing options for local residents).

176. *See id*. at 19 (describing how the University of Southern California stands to benefit greatly by owning huge amounts of real estate in designated tracts and planning to expand—U.S.C. has a "history of expansion that is dotted with displacement" and $5.5 billion endowment that will likely be used for real estate development).

177. *See* Alana Semuels*, When Wallstreet is Your Landlord,* THE ATLANTIC (Feb. 13, 2019), https://www.theatlantic.com/technology/archive/2019/02/single-family-landlords-wall-street/582394/ ("Between 2011 and 2017, some of the world's largest private-equity groups and hedge funds, as well as other large investors, spent a combined $36 billion on more than 200,000 homes in ailing markets across the country.") [perma.cc/TM7L-7JVJ]; *see also Wall Street Landlords turn American Dream into a Nightmare* 10, AMERICANS FOR FIN. REFORM, PUB. ADVOCS. MAKING RTS. REAL & ALL. OF CALIFORNIANS FOR CMTY. EMPOWERMENT INST., https://d3n8a8pro7vhmx.cloudfront.net/acceinstitute/pages/100/attachments/ori

allows corporate landlords to have unfair price-setting power.[178] Starwood Homes, a Real Estate Investment Trust, profited substantially from the 2008 financial crisis by buying homes at significantly reduced prices, and has created a $500 million QOF to further its suspect practices.[179] By providing powerful tax deferral benefits to investors, Opportunity Zones facilitate "wealth building for the wealthy," at the expense of the low-income residents in those communities.[180] "The demolition of historic housing stock also threatens to intensify the indirect displacement pressures on community members by further raising land values in surrounding areas, and by creating developments like luxury housing and upscale shopping that do not serve existing community members and will draw new higher income residents, which can further the cycle of gentrification and displacement."[181]

V. Regulations

While the Opportunity Zone program's purpose is to bring tax benefits to investors and economic development to low-income communities, the program lacks directive rules and restrictions that could aid in pushing capital into depressed communities.[182]

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ginal/1516388955/WallstreetLandlordsFinalReport.pdf?1516388955 ("The concentration of rental housing held by financial companies as capital assets changes the purpose and quality of the housing.") [perma.cc/XL7T-JESH].

178. *See* Semuels, *supra* note 177 (reporting that corporate landlords focus on short-term profits in order to please shareholders at the expense of tenants); *see generally* Ferrer & Donlin, *supra* note 152, at 14.

179. *See generally* Ferrer & Donlin, *supra* note 152, at 14; *see also* James Sprow, *Starwood to Raise $500 Million for Opportunity Zone Investments*, BLUE VAULT (Jan. 31, 2019), https://bluevaultpartners.com/news/starwood-to-raise-500-million-for-opportunity-zone-investments/ ("Starwood, which has a portfolio of 58 properties in Opportunity Zones, intends to invest in markets where it has 'a strong real estate presence,' including the West Coast, Southeast and metropolitan areas like New York and Washington, D.C.") [perma.cc/38Z2-BGV2].

180. *See* Ferrer & Donlin, *supra* note 152, at 14 (highlighting the consequences of treating housing as solely an investment strategy).

181. *Id.*

182. *See generally* Bateman, *supra* note 161 (describing how, unlike previously enacted federal programs meant to attract private investment in low-income communities, no annual Congressional approval or allocation of limited tax credits is required).

"Designating an area is insufficient to ensure engagement with local residents. Without some requirement that the businesses engage with the local community in some way, eligibility based on location likely belies a spatially-oriented tax incentive."[183]

A. Restrictions on "Sin Businesses"

During the proposed regulation's notice and comment period, the Department of Treasury and Internal Revenue Service received several comments regarding "sin businesses."[184] An aspect of the legislation was to prevent a QOZB from operating a sin business; even so, this is circumventable as QOZBs are not prohibited from leasing their property to a sin business.[185] The final regulations prohibit a QOZB from leasing more than 5% of its property to a sin business—a de minimis threshold to reduce risk of QOZB businesses' inadvertently violating the sin business prohibition.[186]

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183. *See* Lorraine Mirabella, *Hogan Proposes $56.5 Million to Spur Development and Business Creation in Maryland 'Opportunity Zones'*, BALT. SUN (Jan. 3, 2019), https://www.baltimoresun.com/business/bs-bz-hogan-opportunity-zone-state-invesmtment-20190103-story.html (detailing Maryland Governor Larry Hogan's proposition to Maryland's Opportunity Zones the most competitive in the nation by having "state agencies work collaboratively with our county and municipal governments and the private sector to supercharge our opportunity zone revitalization") [perma.cc/Q7MT-L7QS].

184. *See* I.R.C. § 144(c)(6)(B) (restricting the financing of certain facilities known as "sin businesses" which includes private or commercial golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks or other facilities used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises); *see also* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1,866, 1,923 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (providing that the final regulations do not extend the prohibition on sin businesses to the definition of a QOF because section 1400Z-2 explicitly prohibits QOZBs from operating sin businesses, but sets forth no such prohibition for QOFs).

185. *See* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1,866, 1,929 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) ("These commenters emphasized that section 1400Z–2(d)(3)(A)(iii) clearly conveyed Congress' intent that a qualified opportunity zone business should not be a sin business, and therefore should not be permitted to circumvent the substance of the sin business prohibition simply through leasing its property to such business.").

186. *See id.* at 1930 (resulting in a QOZB not being invalidated by a small amount of sin business).

The sin business prohibition applies to funds being invested in QOZBs, but does not disallow QOFs from operating sin businesses directly.[187] This inconsistent language creates disparate treatment of sin businesses depending on what kind of entity owns and operates them.[188] In order to prevent this inconsistent treatment of sin business operation, this Note recommends that QOFs also be prohibited from operating sin businesses directly. The purpose of development in these communities should be to promote greater housing affordability and security for families who are most at risk of displacement.[189] Investments should drive growth and prosperity for current low-income residents and disadvantaged communities within the zones, and increase services available to vulnerable populations such as affordable transportation options, health-care facilities, healthy food retail, and quality education services.[190] Allowing sin businesses to operate via QOFs puts communities at risk of investments that may cause more harm than good to low-income residents and defeats the purpose of prohibiting QOZBs from operating sin businesses.

B. The Substantial Improvement Rule

Because the QOF must bring new property to the entity to be used in the Opportunity Zone, a fund that simply acquires property already being used in the zone will not qualify unless it is substantially improved upon.[191] This is to ensure that new

187. *See* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1,866, 1,923 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (creating disparate treatment of sin businesses depending on whether they are being operated by a QOZB or directly in a QOF).

188. *See* Nitti, *supra* note 116 (advising taxpayers to conduct businesses within a zone in a QOZB unless they plan on running a sin business which should operate directly in a QOF).

189. *See* *Recommendations for Opportunity Zones*, POLICYLINK, https://www.policylink.org/sites/default/files/PolicyLink%20Recommendations%20for%20Opportunity%20Zones%20.pdf (advocating for a proactive approach that would guide Opportunity Zones toward such an outcome) [perma.cc/W67P-5L3X].

190. *See id.* (suggesting types of development that these disinvested communities would benefit from and need in order to be lifted and as a result aid in reducing the racial wealth gap).

191. *See generally* Aaron Waites, Jason Walker & Jennifer Proper, *Qualified Opportunity Zones: What Investors Should Know*, WELLS FARGO (May. 2020),

investments and improvements are being made in Opportunity Zones so that taxpayers are not simply acquiring and holding on to existing property indefinitely, unless it is substantially improved by rebuilding or renovation.[192] The substantial improvement requirement mandates improvements equal to the QOF's initial investment in the existing property over a 30-month period.[193]

The May 2019 regulations initially proposed that substantial improvement computations be calculated on an asset-by-asset basis.[194] Many commenters requested that the final regulations adopt an aggregate approach to determine substantial improvement, allowing two or more buildings or structures to be treated as a single unit of property, provided that other qualifications are met.[195] Other commenters recommended retaining the asset-by-asset approach because the alternate approach encourages businesses to "target investments narrowly in rigidly defined areas, preventing broader disbursement of capital investment."[196]

The final regulations have adopted the aggregation approach to determine substantial improvement, and this change has made it easier for buildings and structures to qualify as substantially

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https://www.wellsfargo.com/the-private-bank/insights/planning/wpu-qualified-opportunity-zones/ (providing an explanation and key takeaways for investors and explaining the workings of Opportunity Zones at the funding level) [perma.cc/A3ER-SZD5].

192. *See* Nitti, *supra* note 116 (noting that the spirit of the law does not allow investors to simply buy raw land and hold it for ten years in order to exclude their capital gains because this benefits no one other than the investor).

193. *See* Waites, Walker & Proper, *supra* note 191, at 5 ("For instance, if an Opportunity Zone Fund acquires existing real property in an Opportunity Zone for $1 million, the fund has 30 months to invest an additional $1 million for improvements to that property in order to qualify for this program.").

194. *See* Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18,655 (May 1, 2019) (requesting comments on advantages and disadvantages of adopting an aggregate approach, instead of asset-by-asset, for the application of the substantial improvement rule).

195. *See* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1,866, 1,912 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (requiring that the assets are used in the same trade or business in the Opportunity Zone and improve the functionality of the non-original use assets in the same Opportunity Zone).

196. *See id.* ("Such commenters also emphasized that, by requiring the basis of each discrete asset to be doubled in value, the proposed regulations will ensure a minimum level of investment for each qualified asset.").

improved.[197] For example, imagine two adjacent buildings that have starting bases of $400 and $500 and pass other tests required to aggregate.[198] If a QOZB undertakes improvements and renovations worth $305 for the first building, and $600 for the second, under the proposed regulations the rehabilitation of the first building would have failed because the $305 of rehabilitation is less than its $400 original basis.[199] However, under the final regulations, the total rehabilitation, $905, is more than the aggregate basis of the two buildings, $900, and the rehabilitation passes the Opportunity Zone improvement requirement.[200]

This Note proposes that the asset-by-asset approach be adopted because the aggregate basis approach ultimately reduces the amount of investment that is required to be made in assets within zones. By adopting the asset-by-asset approach, each existing property receives greater investment and addresses commenters' concerns that aggregation would prevent great disbursement of investment. This recommendation, coupled with an employment requirement, would (1) funnel more investment funds into the communities and (2) simultaneously cure the displacement that can result from the substantial improvement requirement, as residents who are employed in the zones are more likely to be able to afford to continue living in those zones.

C. States Taking Action

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197. *See* Nitti, *supra* note 116 ("The regulations allow, in limited circumstances, a QOF or QOZB that owns several buildings within a QOZ to aggregate the basis and improvements made to the buildings for the purposes of measuring substantial improvement.").

198. *See* Forrest David Milder, *Insight: Highlights of the Final Opportunity Zone Regulations,* BLOOMBERG TAX (Jan. 6, 2020, 5:00 AM), https://news.bloombergtax.com/daily-tax-report/insight-highlights-of-the-final-opportunity-zone-regulations (providing this example and walking through the major changes enacted by the December 2019 final regulations) [perma.cc/5TBT-MXV3].

199. *See id.* (explaining that under the proposed regulation asset-by-asset method, at least $400, or the amount of the basis in the property, must have been invested in rebuilding or renovating the property to double its basis and qualify as substantially improved).

200. *See id.* (demonstrating how aggregating allows buildings to pass the substantial improvement test that otherwise would not have passed on an asset-by-asset basis).

While national-oriented frameworks can inform, improve, and provide a broad framework for investment strategies, the types of investors who are inclined to invest in Opportunity Zones are "generally inexperienced in working directly with local residents and leaders."[201] The December 2019 final regulations state that there "are no current or proposed plans to reopen consideration of additional census tracts to be designated as qualified Opportunity Zones."[202] Therefore, local governments should focus on regulating the types of projects that are being invested in and ensuring that they are the kinds of place-based investments that local communities need and will benefit from.[203]

1. The Case in Maryland—Lighting the Way for Other States

Some states—like Maryland—have proposed plans that create initiatives to attract investments that would meaningfully uplift the neighborhoods and struggling communities within Opportunity Zones.[204] The Maryland Department of Commerce provides Maryland Opportunity Zone Enhancement Credits for businesses located in Maryland Opportunity Zones, along with job training programs, small business loans, and affordable housing

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201. *See* Kate Gasparro & David Weinberger, *How to Ensure Opportunity Zone Investments Strengthen Local Communities*, STAN. SOC. INNOVATION REV. (Sept. 6, 2019), https://ssir.org/articles/entry/how_to_ensure_opportunity_zone_investments_strengthen_local_communities (describing the importance of working with city, county, and state governments that have stepped into the role of intermediary, by vetting and prioritizing investments that make the most sense for their communities) [perma.cc/PW83-K6ND].

202. *See* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1,866, 1,941 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (answering commenters who requested that the determination process be reopened, so new qualified Opportunity Zones could be designated, by stating that section 1400Z-1 provides authority for one round of nominations and designations only).

203. *See* Gasparro & Weinberger, *supra* note 201 (providing examples of state-wide approaches such as building partnerships with higher education institutions for long-term change and working with organizations such as Accelerator for America, to "produce guidelines for community-minded investments").

204. *See Maryland Opportunity Zone Enhancement Credits*, MD. DEP'T OF COM., https://commerce.maryland.gov/fund/programs-for-businesses/opportunity-zone-enhancement-credits (outlining the various initiatives) [perma.cc/R63S-BSSP].

incentives.[205] For example, in order to obtain the Jobs Creation Tax Credit, the business needs to create a minimum number of new permanent positions, ranging from ten to sixty, and pay at least 120% of minimum wage within a twenty-four month period.[206]

2. The Case in Colorado—Local Activism

Boulder, Colorado is another example of local level activism.[207] An inundation of investments in Opportunity Zones in Boulder threatened to reshape neighborhoods and increase living costs for residents.[208] The City Council responded with a short-term moratorium to stop the demolition of multifamily homes and the construction of non-residential buildings.[209] The Council provided an "exception for any community-serving Colorado nonprofit corporation that presumably had a better understanding of what local people needed."[210] This type of local activism places community needs at the forefront and uses the Opportunity Zone program to prioritize the welfare of residents.

At the time of this Note, there is no administrative guidance regarding who the businesses being funded by QOFs employ, whether housing in the zones remains affordable for residents, or

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205. *See id*. (providing that if businesses satisfy authorizing conditions, they could be eligible for seven programs offering enhanced tax credits including Job Creation Tax Credit Enhanced Credits, One Maryland Tax Credit Enhanced Credits, More Jobs for Marylanders Income Tax Credit, Enterprise Zone and Enterprise Zone Focus Area Income Tax Credits).

206. *See Job Creation Tax Credit (JCTC)*, MD. DEP'T OF COM., https://commerce.maryland.gov/fund/programs-for-businesses/job-creation-tax-credit (establishing that the number of positions required depends on location and that the amount of the credit given depends on whether the facility is located within a revitalization area and that the total amount of credits allowable do have a ceiling at which they are capped) [perma.cc/YQX2-SSV7].

207. *See* Gasparro & Weinberger, *supra* note 201 (reporting that local communities are not necessarily as active as in Boulder, and many states have other strategies for overseeing and managing Opportunity Zones).

208. *Id.*

209. *See id*. (stopping demolition of multifamily homes or construction of non-residential buildings and noting that the moratorium ensured city officials would discuss new policies and zoning regulations with local residents to ensure that changes brought about via Opportunity Zone investments would benefit the community).

210. *Id.*

whether job opportunities are being created and local economies revitalized. The most pointed critique of the program is that the Opportunity Zones are not actually helping the down-trodden communities they were intended to, and the funds are being funneled into projects and areas that would have received the investments anyway.[211] As a consequence, the ones who are benefiting from the program are wealthy investors, and the low-income residents who can no longer afford living in the areas are displaced.

D. Proposing Regulatory Change

This Note proposes regulatory change that could benefit the intended beneficiaries of the Opportunity Zone regulations. In order to make the Opportunity Zone initiative more productive, it should adopt certain provisions from the NMTC and Empowerment Zone Programs. Rather than allowing investors to self-certify by filing Form 8996, investors and their proposed investments should be approved of by an entity similar to the CDFI Fund—dedicated solely to vetting, approving of, and ensuring that the investments are going toward a purpose that will lift the community in which the asset is placed. This entity should work closely with local governments to discern a community's greatest needs and how the investments can benefit them.

Further, in order to ensure that the legislation fulfills its intended purpose and goal, a regulation should be promulgated requiring that the businesses being created or expanded in Opportunity Zone tracts hire a certain percentage of employees from within that census tract. By hiring residents from within the Opportunity Zone, the legislation will directly impact those communities and assist in uplifting them by reducing displacement through job creation.

For example, North Miami, Los Angeles, Manhattan, and New Orleans are all areas that are designated as Opportunity Zones, and the businesses being funded include luxury hotels and

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211. *See* Drucker & Lipton, *supra* note 33 ("[B]illions of untaxed investment profits are beginning to pour into high-end apartment buildings and hotels, storage facilities that employ only a handful of workers, and student housing in bustling college towns . . . .").

restaurants.[212] This Note proposes that such businesses be mandated to hire 50% of their employees—those who are part of the day-to-day staff and who must be on site and engaged in running the businesses' everyday affairs—from the population that resides within the census tract where the Opportunity Zone is located. Regulating this could foster an environment of economic opportunity, create thousands of new jobs, and revitalize communities and neighborhoods that need help the most.[213]

Additionally, similar to the credit employees receive via Empowerment Zones, investors in Opportunity Zones could receive a credit in exchange for ensuring that their assets' management hire locally.[214] A credit of up to 10% of the first $15,000 in wages paid to each employee who lives and works in the community for up to ten years could incentivize investors to participate actively in the management of the businesses they are investing in and promote job creation. This will also prevent displacement that would have otherwise taken place, especially as a result of the Substantial Improvement Rule, if employees are residents who can afford to live in the designated zones.

1. Arguments Against These Proposals

While critics highlight examples of Opportunity Zones in affluent neighborhoods such as Manhattan and Miami, proponents of the program argue that the majority of Opportunity Zones appear to fit the intended demographic definition and are bringing investments to areas that would not otherwise receive them.[215]

In his February 2020 State of the Union Address, President Trump stated that the Opportunity Zone initiative was one of his

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212. *See generally* Drucker & Lipton, *supra* note 33 (reporting about the wealthy investors with political influence who are planning such luxury investments in contiguous zones that are not actually low-income themselves).

213. *See* Lorraine Mirabella, *supra* note 183 (describing the ways in which the Enhancement program in Maryland could be the most competitive in the country if these goals are met).

214. *See generally* Busso, Gregory & Kline, *supra* note 155 (discussing the origins of the Empowerment Zone status).

215. *See* Fikri & Lettieri, *supra* note 124, at 10 ("Press coverage often broadly—and mistakenly—applies notions of gentrification forged in New York or Washington, DC, to any discussion of community revitalization.").

top achievements since taking office, and the White House has held that the "tax incentive for investors in blighted areas, which has come under fire from Democrats and activists, are not the reason that [B]lack residents of Charlotte and other urban areas are being displaced."[216] In response to arguments that Opportunity Zones provide for "urban renewal" or a way to address blight and crime, Corine Mack, president of the Charlotte chapter of the NAACP, asks why people are still impoverished and predominantly white people are reaping the wealth.[217]

Proponents of the Opportunity Zone regulations could look at the current statistics and state that they are in fact doing exactly what they were intended. A total of 42,176 census tracts were eligible to be designated as Opportunity Zones.[218] Of these, a total of 8,762 were designated, and of those, 8,532 were low-income communities, while 230 were in contiguous communities.[219] Moreover, a total of 31.3 million people across the United States live in areas that have been designated as Opportunity Zones.[220] These statistics may convey that Opportunity Zones seem to be well within the spirit of the policy; however, there are a small share of designations that do not raise legitimate concerns.[221] Furthermore, as discussed in Part II of this Note, the Median

216. *See* Francesca Chambers & Danielle Chemtob, *White House Defends Opportunity Zones Ahead of Trump Visit to Charlotte*, THE CHARLOTTE OBSERVER (Feb. 5, 2020, 5:00 AM), https://www.charlotteobserver.com/news/politics-government/article239946198.html ("The president's push for the tax break comes amid local and national criticism that the wealthy and those connected to Trump are using the tax break to build high-end projects, rather than to help the poor.") [perma.cc/WBT8-RABS].

217. *See id.* (reporting that "Rev. Willie Keaton Jr., a Charlotte activist, views the initiative as similar to urban renewal, a federal policy through which Charlotte demolished hundreds of homes, businesses and churches in what was the city's largest [B]lack neighborhood . . . . Leaders promised to provide new housing for residents, but they never did").

218. *See Opportunity Zones: How Communities Were Selected for Participation,* MISSION INVS. EXCH. (Aug. 2018), https://missioninvestors.org/resources/opportunity-zones-how-communities-were-selected-participation (providing characteristics of selected Opportunity Zones and factual information regarding their demographics) [perma.cc/JE2A-U4Y8].

219. *See id.* ("Up to 5% of those nominated census tracts could be in areas that were contiguous with low-income community census tracts.").

220. *Id.*

221. *Id.*

Family Income data of zones may be skewed by large universities being encapsulated in the zone and large student populations distorting the true income levels in those areas.[222] Additionally, the "outliers should not obscure the fundamental fact that Opportunity Zones are a cohort of places facing enormous socioeconomic challenges."[223]

While investments are indeed being made in the designated zones, they are not achieving the overarching goal and purpose the legislation was enacted for because primarily large investment companies and wealthy investors are benefitting.[224] Without proper direction and an emphasis on prioritizing the distressed communities, paired with proper approval and regulation—which are currently lacking—the investments will further exacerbate the wealth and income disparities prevalent in these census tracts and throughout the country. "Investors are disconnected from the communities where they are placing money, with zero requirements to follow community leadership or in any way include communities in the planning and approval process."[225]

VI. Conclusion

The United States leads the developed world when it comes to income and wealth inequality.[226] Legislation like section 1400Z may continue to perpetuate this trend unless regulations on the

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222. *See* Jacoby, *supra* note 30 (stating that large university student populations skew the MFI data of census tracts).

223. *The State of Socioeconomic Need and Community Change in Opportunity Zones*, ECON. INNOVATION GRP. (Dec. 19, 2018), https://eig.org/news/the-state-of-socioeconomic-need-and-community-change-in-opportunity-zones [perma.cc/HZ3A-AKKQ].

224. *See* Drucker & Lipton, *supra* note 33 ("[L]eaders of groups that work in cities and rural areas to combat poverty say they are disappointed with how it is playing out so far. 'Capital is going to flow to the lowest-risk, highest-return environment,' said Aaron T. Seybert . . . .").

225. *See* Morgan Simon, *Opportunity Zones: We're Doing it Wrong*, FORBES (Sept. 3, 2019), https://www.forbes.com/sites/morgansimon/2019/09/03/opportunity-zones-were-doing-it-wrong/#165546db56fa (outlining three "dangerous" scenarios in which the mutual social benefits of Opportunity Zones may become, or already are, limited) [perma.cc/8XV4-Z2PX].

226. *See* Alston, *supra* note 47, at 4 (reporting that policies enacted by this administration are perpetuating these inequalities).

types of investments are stricter and directed toward the true needs of distressed communities. If altered appropriately, such as along the lines of the suggestions proposed in this Note, the Opportunity Zone legislation could prove fruitful for both investors and residents of low-income census tracts. Meaningful investments could be made in the types of assets that the underserved communities need most.