INVESTING, BUT BETTER: REFORMING THE INVESTING IN OPPORTUNITY ACT

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A few years after the Great Recession, America's economy had largely recovered. However, not all Americans recovered to the same degree, generating significant income inequality. Observing the income disparities across America, Congress enacted the Investing in Opportunity Act (Opportunity Act or the Act) to draw investment into America's most economically distressed communities through tax incentives.

This Note explains that even though the Opportunity Act was ideologically bipartisan and innovative, the Act has failed to effectively provide relief to distressed communities. While the Opportunity Act boasts structural flexibility and, on its surface, appears to incentivize meaningful investment into the economies most in need, the Act in its entirety has introduced unanticipated opportunities for self-dealing at the expense of low-income areas. This Note discusses the overlooked inefficiencies and negative externalities of the Opportunity Act.

Finally, this Note advances an original solution that aligns investors' and low-income communities' incentives. It argues for a greater focus on America's poorest communities, collaboration with local leaders, and additional tax benefits for non-real estate projects.

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Introduction

The recovery following the 2008 Great Recession was highly uneven across the United States, with some parts of the nation "doing remarkably well" and others experiencing "chronic rates of long-term unemployment and historically low levels of new investment."[1] The Economic Innovation Group (EIG) cited dangerous implications related to wealth inequality, including increased rates of suicide, cancer, and divorce.[2] Impoverished youth are unlikely to attain a better economic status than their parents and often find themselves "trapped" in

1. Jared Bernstein & Kevin A. Hassett, Econ. Innovation Grp., Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas (2015), https://eig.org/wp-content/uploads/2015/04/Unlocking-Private-Capital-to-Facilitate-Growth.pdf [https://perma.cc/N7PF-QL2J]; *see also* Sam Pizzigati, *A Stunning Glance at the Geography of U.S. Income Inequality*, Inequality.org (July 19, 2018), https://inequality.org/great-divide/a-stunning-glance-at-the-geography-of-u-s-income-inequality/#:~:text=IN%202015%2C%20top%201%20percenters,gaps%20wider%20than%2035%20times [https://perma.cc/65ZC-AMAS] (stating the top one percent of earners in New York, Florida, and Connecticut made more than thirty-five times that of the average earners).

2. Bernstein & Hassett, *supra* note 1. *About Us*, Econ. Innovation Grp., https://eig.org/about-us#mission (last visited Feb. 15, 2022). The Economic Innovation Group defines itself as a bipartisan organization committed to overcoming problems that plague America's economy. *Id*.

poverty.[3] Despite the compelling circumstances of those most in need, federal tax law in many ways favors wealthy citizens.[4]

One relatively recent federal tax law, however, runs against that trend. Enacted within the Tax Cuts and Jobs Act (TCJA) in 2017, the Investing in Opportunity Act (the Opportunity Act or the Act) was designed to offer generous tax breaks with few qualifying requirements in order to encourage large amounts of investment into America's most distressed communities. In reallocating wealth from one area of the country to an impoverished area elsewhere, the Act is classified as a "place-based policy,"[5] and under it, America's wealthy citizens are heavily incentivized to care for the poor among them.

The original intention behind the Act's flexible structure was presumably to draw enough investment into America's underserved communities to make a significant difference. After all, Congress had previously recognized in other legislation that investors are more likely to participate in less-regulated ventures[6]—a statement with which many academics agree.[7] The flexibility in the Opportunity Act is reminiscent of, and possibly justified by, a theory advanced by Adam Smith:[8]

> [The rich] consume little more than the poor, and in spite of their natural selfishness and rapacity . . . they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal

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3. *Id*. at 2–4.

4. *See, e.g.*, *id.* at 3 ("All the while, better-off cities receive a federal subsidy from the tax exclusion of state and local taxes from federal taxation.").

5. Scott Eastman & Nicole Kaeding, Tax Found., Opportunity Zones: What We Know and What We Don't, (Jan. 2019), http://realnex.production.s3.amazonaws.com/ListingAttachment/748585/7311275.pdf [https://perma.cc/G9M7-35WM]; Hilary Gelfond & Adam Looney, Brookings Inst., Learning from Opportunity Zones: How to Improve Place-Based Policies (Oct. 2018), https://www.brookings.edu/wp-content/uploads/2018/10/looney_opportunity-zones_final.pdf [https://perma.cc/2RMS-C34D].

6. Richard G. Tashjian, *The Small Business Investment Incentive Act of 1980 and Venture Capital Financing*, 9 Fordham Urb. L.J. 865, 871 (1981) (discussing how Congress designed the Small Business Investment Incentive Act of 1980 to give investors "appropriate relief" from regulation so they would invest in distressed businesses).

7. *See, e.g.*, Rebecca Lester, Cody Evans & Hanna Tian, *Opportunity Zones: An Analysis of the Policy's Implications*, 90 State Tax Notes 221, 228 (2018) (implying that less rigid policies "accommodate a wider range of investment opportunities").

8. *E.g.*, Rakesh Sharma, *Who Was Adam Smith?*, Investopedia, https://www.investopedia.com/updates/adam-smith-economics/#[https://perma.cc/3JQE-94SV] (last updated Apr. 11, 2022).

> portions among all its inhabitants, and thus without intending it, without knowing it, advance the interest of the society . . . .[9]

Adam Smith (over-)optimistically envisioned a society where wealthy individuals could act in their self-interest and, "without knowing it," provide poorer individuals with the necessities of life.

Unfortunately, this idyllic idea does not reflect reality. Take, for example, the fact that despite America's capitalist economy, over ten percent of U.S. households—including over five million children in 2019 and almost fourteen million children in 2020—"experienced food insecurity at some point."[10] Without additional incentives, the "invisible hand" does not often lead wealthy individuals to allocate their resources in ways that care for the poor. To this end, Congress crafted the Opportunity Act in an attempt to allocate massive amounts of private capital towards financially attractive enterprises in a way that could significantly ameliorate poverty.[11]

This Note will explain that, like the metaphorical pendulum that swung too far, the Opportunity Act focused so much on attracting investment dollars that it did not adequately condition the tax incentives on effective social investment. While the Opportunity Act has produced some positive results, the results have not met expectations, and the Act has failed to generate its anticipated investment.[12]

In short, the Opportunity Act was structured to allow significant flexibility in an attempt to incentivize enough investment into poor neighborhoods to make a difference. However, adverse to the Act's stated intent and as a result of the Act's flexibility, it has created opportunities for self-dealing and ineffective investment into the very communities Congress sought to lift.

Recent efforts have been made to improve the Act, including bipartisan reform by the same senators who introduced it in 2016.[13] The

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9. *Adam Smith Quotes*, ADAM SMITH INST., https://www.adamsmith.org/adam-smith-quotes (last visited Feb. 17, 2022).

10. Christianna Silva, *Food Insecurity in the U.S. by the Numbers*, NAT'L PUB. RADIO (NPR) (Sept. 27, 2020), https://www.npr.org/2020/09/27/912486921/food-insecurity-in-the-u-s-by-the-numbers [https://perma.cc/X24V-YHNG].

11. *Opportunity Zones*, ECON. INNOVATION GRP., https://eig.org/opportunity-zones (last visited Feb. 17, 2022) ("Opportunity Zones (OZs) were designed with a simple premise: the tax code should encourage private investment in communities that are struggling to attract capital, create jobs, and lift residents out of poverty.").

12. Michelle L. Sidle, Note, *An "Opportunity" to Invest in a "Rat-Infested" City: The Effects of President Trump's Economic Development Plan in Baltimore*, 16 J. BUS. & TECH. L. 143, 143 (2021) ("[S]ome analysis show that Opportunity Zone Funds have raised, on average, 15 percent of their goal amount.").

13. Press Release, *Booker, Scott, Kind, Kelly Introduce Bipartisan Bicameral Bill Reforming Opportunity Zones*, CORY BOOKER (Apr. 7, 2022), https://

proposed improvements mainly address enhancing reporting requirements, focusing efforts on the most impoverished localities, and improving the mechanics of the Act by allowing fund-to-fund investment.[14] While these adjustments are certainly steps in the right direction, this Note further explains the need for reform and suggests additional steps that can be taken to improve the most impoverished areas of the United States.

The rest of this Note will proceed in three parts. Part I gives a brief background on place-based policies and the Investing in Opportunity Act.[15] Part II assesses the Act's merits by offering a comprehensive analysis of equity, efficiency, and administrability considerations. Part III proposes amendments that would improve the Act's efficiency through stricter investment requirements and coordination with local governments.

I.
History and Basics of the Investing in Opportunity Act

As mentioned above, the Opportunity Act is a place-based policy that offers tax incentives to encourage investment into underserved communities. Thus, Congress had two overarching objectives in crafting the Act: to identify underserved communities and to encourage investment in these communities using tax incentives. This Part of the Note describes the history and mechanics of the Opportunity Act. Although not intended to provide an exhaustive review of the Opportunity Act and its accompanying regulations,[16] the following sections will lay out the Act's framework to reveal the legal flexibility that investors currently enjoy.

A. History of Place-Based Policies

Far from being an ad hoc first attempt, the Opportunity Act is rooted in a large body of research and practical experience drawn from economic think tanks, policymakers, and prior place-based policies.

www.booker.senate.gov/news/press/booker-scott-kind-kelly-introduce-bipartisan-bicameral-bill-reforming-opportunity-zones [https://perma.cc/FH8Z-62NC].

14. *See generally* Opportunity Zones Transparency, Extension, and Improvement Act, S. 4065, 117th Cong. (2022).

15. Gelfond & Looney, *supra* note 5, at 12 (alleging the Act lacks adequate "guardrails").

16. The U.S. Department of the Treasury (Treasury) and Internal Revenue Service (IRS) issued 544 pages of final regulations in 2019 to clarify several of the Act's ambiguities.

Recognizing that wealth was unequally distributed throughout cities in the United States, Jared Bernstein and Kevin Hassett of the Economic Innovation Group sought to create a place-based policy superior to its predecessors. After reviewing prior place-based policies,[17] the authors concluded that the overall effect of such policies on their targeted communities is uncertain.[18] The Tax Foundation came to the same conclusion and even suggested that place-based policies may produce negative externalities within the economies of the very communities they seek to uplift.[19]

Bernstein and Hassett identified several possibilities that likely led prior place-based policies to produce marginally beneficial results.[20] These possibilities included the complexity of the policies, unrealistic timelines, restrictive criteria, inability to raise capital, and an overall inadequate effort to educate the public about these initiatives.[21] Their research implicitly chalked up much of the failure to inadequate incentives and cumbersome processes.

In response to these issues, Bernstein and Hassett proposed an improved and flexible place-based policy that would utilize powerful tax incentives to move large amounts of capital into impoverished neighborhoods.[22] They designed a tax structure that offered generous rewards contingent on meeting a few requirements. Under their proposal, the nation would create a place-based policy that would operate like an investment fund, investing in small businesses within designated underdeveloped areas.[23] Their approach had two advantages over prior place-based policies. First, these specialized investment firms could evaluate projects and coordinate efforts better than previous place-based policies. Second, institutional investors, along with individuals, could invest in these funds—a surprisingly infrequent occurrence under the prior place-based policies.[24] So long as an invest-

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17. Bernstein & Hassett, *supra* note 1, at 2–11.

18. *Id.* at 4–12 (explaining the mechanics and objectives of prior and ongoing place-based policies, including Empowerment Zones, Renewal Communities, and the New Market Tax Credit).

19. Eastman & Kaeding, *supra* note 5, at 7–9.

20. Bernstein & Hassett, *supra* note 1, at 11–16 (concluding that the most optimistic studies showed "little more than marginal gains in areas covered by the programs.").

21. *Id.*

22. *Id.* at 16–19.

23. *Id.* at 17 (discussing how in other words, the place-based policy would operate like "a venture capital firm or mutual fund company" that "specialized in development investments in businesses in predetermined locales").

24. *Id.* ("[E]xisting and prior approaches have not harnessed the power of intermediaries such as private equity firms, banks, venture capitalists, mutual funds, and hedge funds. By focusing on often small individual businesses, policies have implic-

ment happened within the designated area, it would qualify for favorable tax treatment.[25]

Not long after their report, Bernstein and Hassett's proposed policy gained traction. After the policy was dismissed by the 114th Congress in 2016, it was reintroduced in the 115th Congress in 2017 by both Republican and Democratic officials.[26] Bipartisan support ensured that it moved quickly through the legislative process.[27] On December 22, 2017, the policy was enacted into law as the "Investing in Opportunity Act" as part of the Tax Cuts and Jobs Act.[28]

The Opportunity Act was passed with high expectations.[29] Optimists claimed that the Act could affect 1.6 million businesses, create 24 million jobs, and direct over $100 billion of private capital into the underserved target communities.[30] Even though the Act would cause the federal government to lose an estimated $1.6 billion in revenue per year for its first eight years, in theory the Act would lower future governmental costs by supplanting government involvement in impoverished communities.[31] The Act would be a win-win-win scenario: underserved communities would have more access to funding; investors would obtain favorable tax treatment on their profits; and federal, state, and local governments would receive assistance from the private sector in addressing social-economic problems that governments would otherwise be expected to solve.

Despite this initial excitement, however, the Opportunity Act has been subject to vehement criticism since its passage. While the Act has drawn investment into low-income neighborhoods,[32] critics have

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itly required an unrealistically large amount of coordination among potential investors, and hence, have failed.").

25. *Id.*

26. The policy was introduced by fourteen members of Congress, including Republican Senator Tim Scott and Democratic Senator Cory Booker.

27. *History of Opportunity Zones*, ECON. INNOVATION GRP., https://eig.org/opportunityzones/history (last visited Feb. 17, 2022); *see* Lester et al., *supra* note 7, at 228.

28. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97.

29. Sidle, *supra* note 12, at 143.

30. *Id.* at 143–44; Ruth Simon & Peter Grant, *Opportunity-Zone Funds Are Off to a Slow Start, Lagging Behind Heady Expectations*, WALL ST. J. (Oct. 22, 2019, 7:00 AM), https://www.wsj.com/articles/opportunity-zone-funds-are-off-to-a-slow-start-lagging-behind-heady-expectations-11571742002) [https://perma.cc/NJC8-VF97].

31. JOINT COMM. ON TAX'N, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT", JCX-67-17, at 6 (Dec. 18, 2018).

32. SEAN LOWRY & DONALD J. MARPLES, CONG. RSCH. SERV., R45152, TAX INCENTIVES FOR OPPORTUNITY ZONES: IN BRIEF 7–8 (2018) (quoting Brett Theodos, Brady Meixell & Carl Hedman, *Did States Maximize Their Opportunity Zone Selections?*, URB. INST. (May 21, 2018), https://www.urban.org/research/publication/

accused it of being more of a political gesture than an economic strategy.[33] Specifically, think tanks and academics have criticized the Opportunity Act for failing to ensure that all the communities receiving investments truly needed them,[34] confirm that the investments in low-income communities would actually benefit poor residents,[35] and create reporting systems to measure the impact of its tax breaks.[36] Taken together, the Opportunity Act's current structure allows investors to claim the Act's tax benefits without producing benefits in low-income communities.

In prior place-based policies, Congress imposed numerous conditions to ensure the policies produced positive societal impacts. One place-based policy akin to the Opportunity Act, the New Market Tax Credit (NMTC), was enacted in 2000 "to alleviate poverty, reduce unemployment, and boost economic activity."[37] Put succinctly, the NMTC offers a thirty-nine percent, nonrefundable tax credit over a seven-year period to businesses that qualify as Community Development Entities (CDEs).[38] Qualifying for the credit, however, is no small task. To qualify as a CDE, an entity must not only be organized primarily to serve low-income communities but also meet reporting and compliance requirements.[39] Moreover, a CDE is not *per se* entitled to the NMTC. Even after a CDE files a NMTC application with the Community Development Financial Institutions Fund (CDFI Fund), organized under the Department of the Treasury (Treasury), the CDFI Fund must be convinced that the CDE has adequately demonstrated that its investments will improve community outcomes—such as benefiting low-income citizens and providing entry-level jobs—

did-states-maximize-their-opportunity-zone-selections [https://perma.cc/SQT2-C23D]).

33. Sidle, *supra* note 12, at 150 (stating that some "believe that the initiative was more of a political statement than an investment in poor communities").

34. Gelfond & Looney, *supra* note 5, at 8 ("[I]n some cases states sought loopholes or otherwise picked places that did not need the help or were already on their way to success.").

35. CONG. RSCH. SERV., R45152, at 6.

36. Cary Martin Shelby, *Profiting from Our Pain: Privileged Access to Social Impact Investing*, 109 CALIF. L. REV. 1261 (2021) (discussing how the Opportunity Act "failed to include any concrete obligations to report or measure any identified impact objectives for enterprises taking advantage of these tax breaks.").

37. BERNSTEIN & HASSETT, *supra* note 1, at 5.

38. SEAN LOWRY, CONG. RSCH. SERV., R42770, COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFI) FUND: PROGRAMS AND POLICY ISSUES 12 (2018).

39. *Id.* at 5–6; *CDE Certification, Step 2: Reporting*, DEPT. TREASURY CMTY. DEV. FIN. INSTS. FUND, https://www.cdfifund.gov/ [https://perma.cc/KS4T-UR9F].

before approving the tax credit.[40] NMTC's rewards were well-guarded by the CDFI Fund to prevent abusive practices.

As of September 2021, the CDFI Fund has awarded $66 billion to CDEs in NMTCs.[41] Although this is a significant amount of capital, a 2010 report by the Government Accountability Office (GAO) concluded that the NMTC's rigidity and complexity limit the NMTC's potential by steering smaller investments away from low-income community businesses.[42] Had the NMTC program been drafted more loosely, the CDFI Fund likely would have awarded more funding to low-income communities.[43] Some believe that tight limits like those imposed on the NMTC simply ensure that federal subsidies produce public benefits,[44] while others claim fund requirements may instead *deter* investment.[45] Compared to the NMTC and other place-based policies, the Opportunity Act imposes relatively few requirements.

Although the Opportunity Act has the same objective as other place-based policies, its structure differs significantly from the others. The Act, like its predecessors, was designed to improve some of America's poorest neighborhoods. However, unlike many of its predecessors, the Act accommodates a variety of investment projects and structures. These accommodations increase the Act's ability to attract investment but could also lead to abusive investment practices. A review of the Opportunity Act's mechanics and incentive structures is necessary to recognize the areas of potential abuse.

B. The Mechanics of Investing in Economically Distressed Communities

1. Eligible Tracts

In defining which areas are eligible for the tax incentives—areas referred to as "Eligible Tracts"—the Opportunity Act did not ensure that qualifying investments would go only to currently impoverished areas. An Eligible Tract could either be (i) a low-income community

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40. *Id.* at 7–8.

41. Press Release, U.S. Dep't. of the Treasury, CDFI Fund Announces $5 Billion in New Markets Tax Credits, (Sept. 1, 2021), https://home.treasury.gov/news/press-releases/jy0340 [https://perma.cc/H3N5-JHR2].

42. CONG. RSCH. SERV., R42770, at 13 (explaining how the rigidity and complexity make "it more difficult for CDEs to execute smaller transactions and results in less equity ending up in low-income community businesses than would likely end up there were the transaction structures simplified.").

43. With that said, a later GAO report admitted that measuring the NMTC's effectiveness is difficult. *Id.*

44. GELFOND & LOONEY, *supra* note 5, at 12.

45. *See* CONG. RSCH. SERV., R42770, at 13.

(LIC) or (ii) an area contiguous to an LIC with a median family income not more than 125 percent of the LIC to which it is contiguous (Contiguous Area).[46]

An LIC is defined as any census tract that has (i) a poverty rate of at least twenty percent, (ii) a median household income equal to or less than eighty percent of the statewide median household income, or (iii) a median household income equal to or less than eighty percent of the metropolitan area median household income, if the tract was located in a metropolitan area.[47] The poverty rates and median household incomes of the Eligible Tracts are based on census data recorded in 2011.[48] The Eligible Tracts that were ultimately selected are referred to in the Opportunity Act as "Qualified Opportunity Zones" (QOZs).[49]

Congress granted substantial leeway in designating Eligible Tracts as QOZs. The Internal Revenue Code (Code) merely explains that the "chief executive officer" of each state (State CEO) can nominate up to twenty-five percent of the Eligible Tracts within their own state as QOZs.[50] Congress essentially delegated to the states the power to choose which communities the Opportunity Act would serve. Congress's largest limitation on QOZ selection was the requirement that Eligible Tracts must be either LICs or Contiguous Areas. Yet, despite this "limitation," fifty-seven percent of American neighborhoods qualified as Eligible Tracts.[51] And as of 2016—less than two years before the TCJA—almost half of Eligible Tracts had poverty rates below the twenty percent threshold.[52]

Moreover, because the Eligible Tracts were determined using 2011 census data, many cities' economic circumstances changed by

46. I.R.C. §§ 1400Z-1(c), (e). Contiguous Areas could not constitute more than five percent of a state's QOZs. § 1400Z-1(e)(2).

47. *Id.* Congress incorporated the NMTC's definition of an LIC into the Opportunity Act. I.R.C. § 45D(e).

48. Adam Looney, *Will Opportunity Zones Help Distressed Residents or Be a Tax Cut for Gentrification?*, BROOKINGS INST.: UP FRONT (Feb. 16, 2018), https://www.brookings.edu/blog/up-front/2018/02/26/will-opportunity-zones-help-distressed-residents-or-be-a-tax-cut-for-gentrification/ [https://perma.cc/Z6SR-MMA4].

49. I.R.C. § 1400Z-1(a).

50. I.R.C. § 1400Z-1(b). If a state had less than 100 Eligible Tracts, the respective State CEO could nevertheless nominate up to twenty-five QOZs. *Id.* This nomination is subject to certification by the Secretary of the Treasury or their delegate. I.R.C. § 7701(a)(11)(B).

51. GELFOND & LOONEY, *supra* note 5, at 1.

52. Adam Looney, *The Early Results of States' Opportunity Zones Are Promising, but There's Still Room for Improvement*, BROOKINGS INST. (Apr. 18, 2018), https://www.brookings.edu/research/the-early-results-of-states-opportunity-zones-are-promising-but-theres-still-room-for-improvement/ [https://perma.cc/D3BN-AVSF].

the time State CEOs were making their nominations.[53] The Opportunity Act's current structure facilitates investment in communities that have likely improved since 2011 and would no longer qualify as an Eligible Tract while potentially excluding recently distressed communities that did not meet the Eligible Tract requirements in 2011.

2. *Qualified Opportunity Funds*

Though investing in QOZs would seem to always benefit poor citizens therein, qualifying investment structures suggest that investors can structure their investments to maximize financial returns while incidentally minimizing social impact.

Taxpayers invest in QOZs through Qualified Opportunity Funds (QOFs). Congress defines a QOF as any investment vehicle organized as a corporation or partnership that self-certifies as a QOF on Form 8996 and holds at least ninety percent of its assets in QOZ property (Ninety Percent Rule).[54] However, complexity arises in the definition of QOZ property. QOZ property can take on three basic forms: (i) qualified opportunity zone stock (QOZ Stock), (ii) qualified opportunity zone partnership interest (QOZ Partnership Interest), and (iii) qualified opportunity zone business property (QOZ Business Property).[55]

To be considered QOZ Stock or QOZ Partnership Interest, the stock or partnership interest must be originally issued by domestic corporation or a partnership that is a qualified opportunity zone business (QOZ Business) and belong to that business for substantially the whole time the QOF held the stock or partnership interest.[56]

To be QOZ Business Property, the business property must (i) be tangible property used in the QOF's trade or business, (ii) have its

53. *Id.* (revealing that many Eligible Tracts constituted "areas with higher-than-average home price appreciation—one indication of gentrification."). These issues are further discussed in Part II.B.2. The use of 2011 data has the potential to both (1) include localities that have since improved their economic status and would no longer be eligible for Eligible Tract status if more recent data were used and (2) exclude localities that have seen recent economic declines that would now be eligible for Eligible Tract status but were not deemed impoverished enough in 2011.

54. I.R.C. § 1400Z-2(d)(1). QOFs organized as corporations may include regulated investment companies (RICs) and real estate investment trusts (REITs). JOINT COMM. ON TAX'N, 115TH CONG., QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 20 (June 19, 2019). Recent proposals have modified the definition of QOFs slightly but all QOFs continue to have a threshold of at least ninety percent. *See* H.R. 7467, 117th Cong. § 302(a)(1) (2022).

55. I.R.C. § 1400Z-2(d)(2)(A).

56. I.R.C. §§ 1400Z-2(d)(2)(B)–(C).

original use commence with the QOF (or not, so long as the QOF improves such property),[57] and (iii) be used substantially within the QOZ during substantially the whole time such property was held by the QOF.[58] In regards to this last requirement, the IRS has clarified that, as written therein, the first "substantially" means seventy percent and the second "substantially" means ninety percent.[59]

Determining whether stock or partnership interests constitute QOZ Stock or QOZ Partnership Interests is vital to determining whether stock or partnership interests constitute QOZ Stock or QOZ Partnership Interests is knowing what constitutes a QOZ Business. As defined in the Code, a QOZ Business is a trade or business in which substantially all of the tangible property owned or leased by the business is QOZ Business Property, among other requirements.[60] According to the Joint Committee on Taxation (JCT), "substantially all" in the definition of QOZ Business means seventy percent.[61] Though whether stock and partnership interests qualify as QOZ Stock and QOZ Partnership Interests initially turns on the stock and interests being in QOZ Businesses, this determination ultimately comes down to whether such stock and partnership interests were issued from businesses with sufficient QOZ Business Property—the third form of QOZ property.[62] Thus, whether a QOF meets the Ninety Percent Rule—and consequently achieves the Act's favorable tax treatment—largely hinges on the definition of QOZ Business Property, the implications of which will be discussed below.[63]

C. *Tax Incentives to Drive Investment*

To encourage investment, the Opportunity Act offers three interrelated tax incentives. Each of the tax incentives requires investors to

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57. I.R.C. § 1400Z-2(d)(2)(D)(ii). A QOF substantially improves property if its improvements to the property more than double the property's basis and the improvements are made within thirty months of acquisition. *Id.*

58. I.R.C. § 1400Z-2(d)(2)(D).

59. Opportunity Zones Frequently Asked Questions, INTERNAL REVENUE SERV., at Q52 [hereinafter I.R.S. F.A.Q.], https://www.irs.gov/credits-deductions/opportunity-zones-frequently-asked-questions [https://perma.cc/VY29-3GDQ] (last updated Nov. 10, 2022) (defining "substantially all" in the definition of QOZ Business Property). Taken together, tangible property needs to be used only sixty-three percent within a QOZ to qualify as QOZ Business Property. *Id.*

60. I.R.C. § 1400Z-2(d)(3).

61. JOINT COMM. ON TAX'N, 115TH CONG., QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 30 (June 19, 2019).

62. In addition to QOZ Business Property, the Act imposes four other requirements on QOZ Businesses, none of which are very limiting. JOINT COMM. ON TAX'N, 115TH CONG. QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 32 –38 (June 19, 2019).

63. *See infra* Part II.B.2.b.

invest in a QOF.[64] The first tax incentive relates to the deferral of taxation on gains invested into a QOF, the second incentive decreases the gain recognized by investors by increasing their basis, and the final incentive allows investors to eliminate gains accumulated through QOF investments entirely.

1. *Tax Deferral for QOF Investments*

The Act's first tax incentive is a tax deferral for gains invested in a QOF. Taxpayers who elect[65] to reinvest realized capital gains in a QOF will temporarily defer the tax on those gains.[66] Upon the earlier of either the Act's expiration[67] or the sale of the investment, the taxpayer would include the invested gains in their taxable income.[68]

For example, if a real estate investor sold a piece of real estate in New York City for $15 million when she had a basis of $5 million, the taxpayer would be left with a taxable capital gain of $10 million. However, if the taxpayer then invested $10 million into a QOF, taxation of the $10 million gain would be deferred until the earlier of when either the Act expires or the investment is sold. For several reasons, the real estate investor would prefer to be taxed on the $10 million in the future rather than on the $10 million in the year she sold the real estate for $15 million.[69]

2. *Tax Reduction Through Basis Step-Up*

The second tax incentive offered by the Opportunity Act is decreasing the gain recognized by giving investors a step-up in basis on the investment in a QOF.[70] Since investments into the QOF are often

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64. I.R.C. § 1400Z-2(a)(1).

65. The election must be made within 180 days of when the gain was realized. I.R.S. F.A.Q., *supra* note 59, at Q22 (discussing the 180-day investment period).

66. I.R.C. § 1400Z-2(a). Also worth noting, Congress allows deferral of both long-term and short-term capital gains. *See generally* I.R.C. § 1400Z-2. With that said, Congress cabins which capital gains may receive tax-deferral treatment by offering it only for gains arising "from the sale to, or exchange with, an unrelated person." I.R.C. § 1400Z-2(a)(1).

67. This is currently set to be December 31, 2026. I.R.C. § 1400Z-2(b)(1)(B). However, proposed legislation would extend the Act's application until December 31, 2028. H.R. 7467, 117th Cong. § 301(a) (2022).

68. I.R.C. §§ 1400Z-2(b)(1)(A)–(B).

69. This is, at least in part, due to the time value of money. While in most situations taxpayers prefer to defer gains on property, there are several circumstances that would influence taxpayers to forgo tax deferral, such as an immediate need for liquid assets or the taxpayer's ability to offset a gain with losses that would otherwise go unused.

70. Gains are often calculated by subtracting the amount realized from the basis. Gains, and subsequent taxes, are decreased when the basis of an asset is increased.

untaxed gains, the basis in that investment is zero[71]—meaning the entire value of the untaxed gains[72] invested into the QOF would eventually be realized.[73] If a taxpayer holds their interest in the QOF (QOF Interest) for a set period of time, however, the taxable portion of the invested gain decreases.

The basis in the investment increases at two time-based milestones: five years and seven years. If the taxpayer holds her QOF Interest for five years, her basis increases by ten percent of her investment. If she holds her QOF Interest for an additional two years (i.e., seven years total), her basis increases by an additional five percent of the invested gains.[74]

Returning to the previous example, if the real estate investor were to leave her $10 million in the QOF for five years, she would receive a step-up in basis equal to ten percent of her QOF Interest, resulting in a $1 million basis and a tax on only $9 million of the original investment.[75] If she were to leave her investment in the QOF for seven years, she would receive a step-up in basis equal to five percent of her QOF, or an additional $500,000—leaving only $8.5 million of the original $10 million gain to be taxed.[76]

3. *Ten-Year QOF Interest Gain Elimination*

In addition to the tax deferral and the basis step-up, the Opportunity Act allows some taxpayers to permanently exclude post-acquisition gains arising from QOF Interests if the taxpayers hold the QOF Interests for at least ten years.[77] This elimination only applies to the gains on the original QOF Interests, not to the built-in gains of QOF Interests.[78] This means that if the real estate investor were to leave her $10 million gain invested in the QOF for ten years or more

71. I.R.C. § 1400Z-2(b)(2)(B)(i).

72. These gains are often untaxed as a result of the tax deferral described in Part I.C.1.

73. When a gain is realized, it is often taxed. As described above, gains are often calculated by subtracting the amount realized from the basis. When the basis in the gains invested is zero, the full value of the gains is taxed.

74. I.R.C. §§ 1400Z-2(b)(2)(B)(iii)–(iv).

75. I.R.C. § 1400Z-2(b)(2)(B)(iii).

76. I.R.C. § 1400Z-2(b)(2)(B)(iv).

77. I.R.C. § 1400Z-2(c); JOINT COMM. ON TAX'N, 115TH CONG., QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 10 (June 19, 2019). Proposed regulations indicate that taxpayers can make this election until December 31, 2047. *Id.* This final tax incentive has been described as the "largest tax benefit associated with [the Act's] tax incentives . . . ." LOWRY & MARPLES, *supra* note 32, at 8.

78. Notably, at the expiration of the Act (currently set for December 31, 2026) or the sale of the QOF Interests, the taxpayer would recognize gain on the QOF Interest value that exceed the basis. § 1400Z-2(b)(1).

and that QOF Interest were to appreciate to $14 million, she would be able to exclude the $4 million of investment appreciation.[79]

Congress reasonably believed that it needed to provide powerful incentives to encourage investment in impoverished areas. These incentives must also be coupled with anti-abuse restrictions, however, to ensure the Act's tax benefits are contingent upon truly serving such communities' social and economic needs.

II.
Evaluating the Opportunity Act

Despite its merits, the Opportunity Act has received substantial criticism. The main criticism has been an equitable one that most place-based policies have encountered, namely that wealthy investors are benefitting from the Act on the false premise that they are supporting underserved communities.[80] Other critics make efficiency and administrative arguments, but most of these criticisms are not particularly detailed.[81] Additionally, many scholars and commentators who made these arguments had a narrow geographic focus,[82] made them in reliance on supporting legislation that never passed,[83] or commented before the IRS issued a slew of regulations.[84] Further, the GAO only recently published a report identifying and assessing equity concerns, efficiency issues, and compliance challenges that the Act poses for the IRS.[85] To provide a fresh, comprehensive evaluation of

79. Note, however, that the basis in the invested gains increases only relative to the capital gains that comprise it and the basis will never increase for the gains invested into a QOF. In other words, the remaining $8.5 million of the original $10 million investment would still be taxed.

80. *E.g.*, Joseph Bennett, *Lands of Opportunity: An Analysis of the Effectiveness and Impact of Opportunity Zones in the Tax Cuts and Jobs Act of 2017*, 45 J. Legis. 253, 271 (2019) ("However, the major problem with this program is the lack of actual help provided to the communities.").

81. *See id.* at 257.

82. Sidle, *supra* note 12, at 157.

83. Edward W. De Barbieri, *Opportunism Zones*, 39 Yale L. & Pol'y Rev. 82, 143 (2020); Opportunity Zone Reporting and Reform Act, S. 2787, 116th Cong. (2019).

84. Press Release, U.S. Dep't of the Treasury, Treasury and IRS Issue Final Regulations on Opportunity Zones (Dec. 19, 2019), https://home.treasury.gov/news/press-releases/sm864 [https://perma.cc/E28A-JJN9]. *See generally* Gelfond & Looney, *supra* note 5; Eastman & Kaeding, *supra* note 5; Kelly Frey, *Opportunity Zones: The Good, the Bad and the Ugly*, Law 360 (Jan. 29, 2019), https://www.law360.com/articles/1122587/opportunity-zones-the-good-the-bad-and-the-ugly [https://perma.cc/VUB3-7DWR].

85. U.S. Gov't Accountability Off., GAO-22-104019, Opportunity Zones: Census Tract Designations, Investment Activities, and IRS Challenges Ensuring Taxpayer Compliance (2021).

the Opportunity Act, this Part will look at the Act through the lenses of equity, efficiency, and administrability.

A. Equity

Though counterintuitive given its stated purpose, the Opportunity Act is inequitable. Equity in tax policy, as in the colloquial sense, is about fairness—although the definition of "fair" is often debated. A tax policy's equity is often evaluated in two forms: vertical equity and horizontal equity.[86] As explained below, the current state of the Opportunity Act raises concerns under both.

1. Vertical Equity

Vertical equity exists when those with a greater ability to pay end up paying more taxes than those with a lesser ability to pay.[87] As explained in Part I, the Opportunity Act is structured to lower taxes not for middle- or low-income taxpayers but for wealthy ones—i.e., those with greater ability to pay—who invest in QOFs.[88] While many tax benefits are known to be disproportionately available to wealthier taxpayers,[89] the Act's tax incentives are also notably more available to wealthier taxpayers. As a result, the Opportunity Act lacks vertical equity. Although poorer taxpayers that live in economically troubled communities likely benefit from the Act's application, these poorer taxpayers are not the ones receiving the Act's favorable tax benefits.[90]

In addition to the residents of QOZs who do not see a decrease in their tax rates from the Act, most middle-class Americans, regardless of their residence, also are unlikely able to take advantage of the Act's

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86. Christopher H. Hanna, Tax Policy in a Nutshell 33 (2d ed. 2022).

87. *Id.*

88. Bennett, *supra* note 80, at 268 (citing U.S. Gov't Accountability Off., GAO-05-1009SP, Understanding the Tax Reform Debate: Background, Criteria, & Questions 28 (2005)) ("The tax benefits available through the [Opportunity Act] are only available to the wealthiest of people in the country. These substantial tax breaks will significantly reduce their effective tax rates, while those living in the targeted communities will still be subject to the same rates as before.").

89. This can be seen in complex tax strategies that are only available to taxpayers who have enough disposable income to both acquire an attorney and engage in investments that are unfeasible for many less-wealthy taxpayers. This is also the case with itemizable deductions, as wealthy taxpayers are in a position to itemize far more often than less-wealthy taxpayers. *See, e.g.*, *What Are Itemized Deductions and Who Claims Them?*, Tax Pol'y Ctr., at fig. 2, https://www.taxpolicycenter.org/briefing-book/what-are-itemized-deductions-and-who-claims-them [https://perma.cc/Z254-NCVP] (last visited Oct. 4, 2022).

90. Bennett, *supra* note 80, at 268 (citing U.S. Gov't Accountability Off., GAO-05-1009SP, Understanding the Tax Reform Debate: Background, Criteria, & Questions 28 (2005)).

deferral, reduction, and exclusion. This is for at least three reasons. First, QOF investment minimums are six-figures.[91] Second, capital gains are held primarily by wealthy taxpayers.[92] And third, significant resources are required to navigate the Act's complexity.[93]

As Bernstein and Hassett predicted, the Act would target the wealthy to draw their wealth into impoverished communities.[94] Whether or not it was a conscious decision, Congress chose to create a *vertically inequitable* tax policy because the policy, at least in theory, would produce equitable outcomes. For several reasons, however, the Opportunity Act, even viewed in its entirety, has hitherto produced inequitable outcomes for poor residents in QOZs.

2. *Horizontal Equity*

Horizontal equity exists when those in similar financial situations receive similar tax burdens.[95] In addition to its lack of vertical equity, the Opportunity Act lacks horizontal equity because investors with equal abilities to pay can end up with significantly different tax liabilities depending on how familiar they are with the Opportunity Act.

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91. De Barbieri, *supra* note 83, at 140 (citing Ryan Ermey, *Opportunity Zone Investing: Is It for You?*, KIPLINGER (June 5, 2019), https://www.kiplinger.com/article/investing/T041-C000-S002-opportunity-zone-investing-is-it-for-you.html [https://perma.cc/G7X3-MANJ] (stating that most QOFs require "a six-figure investment minimum"). Even the relatively few middleclass, or even upper-middleclass, Americans who have spare capital gains to invest are foreclosed from such QOF investment opportunities due to this high barrier to entry.

92. Although the United States has estimated that trillions of dollars of unrealized capital gains are eligible for the Opportunity Act's favorable tax treatment, capital gains are held primarily by the wealthiest Americans. *See generally Income Inequality in the United States*, INEQUALITY.ORG, https://inequality.org/facts/income-inequality/ [https://perma.cc/C7ZW-3AZN] (last visited Jan. 27, 2023); De Barbieri, *supra* note 83, at 139 ("Reports indicate that capital gains go overwhelmingly to already well-off families."); Sidle, *supra* note 12, at 146. Moreover, only seven percent of Americans reported taxable gains in 2016, with the majority being reported by households with annual income exceeding $1 million. Ruta R. Trivedi, Note, *Opportunity Zones Providing Opportunity for Whom?: How the Current Regulations Are Failing and a Solution to Uplift Communities*, 27 WASH. & LEE J. C.R. & SOC. JUST. 745, 757 (2021); GELFOND & LOONEY, *supra* note 5, at 11 ("The top income quintile pays 96 percent of the positive tax on capital gains.").

93. De Barbieri, *supra* note 83, at 138–39 ("[C]omplying with the regulations of the [Opportunity Zone Act] creates significant barriers to individuals and groups participating in zone investments. Complying with the requirements will no doubt require significant expenses including professional tax, financial, and legal assistance.").

94. *See generally* BERNSTEIN & HASSETT, *supra* note 1.

95. Bennett, *supra* note 80, at 268 (quoting U.S. Gov't Accountability Off., GAO-05-1009SP, UNDERSTANDING THE TAX REFORM DEBATE: BACKGROUND, CRITERIA, & QUESTIONS 27 (2005)).

By virtue of the Act's elective nature,[96] investors in QOZs can structure their businesses as QOFs to reap the Act's full tax benefits. Some investors in QOZs, however, either are not familiar with the Opportunity Act or are simply intimidated by its increasing regulatory complexity.[97] As a result, while some similarly situated taxpayers might structure their investments or businesses as QOFs, others might not.[98]

Thus, whether the taxpayer is a businessperson, investor, or an entrepreneur in a QOZ, mere awareness of the Opportunity Act and how to navigate it can significantly lower one taxpayer's tax liability relative to a taxpayer who lacks such awareness yet has an identical ability to pay. Similarly, comparing businesses in Eligible Tracts not designated as QOZs, with the same ability to pay as businesses in QOZs, the non-QOZ businesses will not receive the benefits the Act gives to the QOZ businesses.

While almost all tax breaks that require an election, as well as a certain level of sophistication to understand and take advantage of the tax break, result in some level of horizontal inequity, tax policies are often justified by one of the other main tax pillars. As mentioned above, equity is just one of the three main pillars by which tax policy is evaluated—efficiency and administrability remain. Yet, like equity, the efficiency and administrability pillars raise further questions about the Act's application.

B. Efficiency

The Opportunity Act also lacks efficiency. Whereas equity focuses on fairness, efficiency focuses on taxpayer behavior and outcomes.

Efficiency exists if a tax system or tax provision does not affect the structure or occurrence of economic transactions.[99] Conversely, a tax system or provision that affects such decisions is *inefficient*. Many

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96. Becoming a QOF does not require an application or external approval, only self-certification on a Form 8996. *See supra* Part I.B.

97. De Barbieri, *supra* note 83, at 138–39 ("As a result, simply complying with the regulations of the [Opportunity Zone Act] creates significant barriers to individuals and groups participating in zone investments.").

98. Bennett, *supra* note 80, at 268 ("[T]wo taxpayers—one a corporation, and one an individual—each have identical gross income, purchase identical properties next door to one another, and redevelop them into identical new buildings. Because of the Opportunity [Act], they could have vastly different levels of adjusted gross income—and, therefore, tax liability—at the end of the year just because of the fact that one is a legal entity and the other is not.").

99. HANNA, *supra* note 86, at 37 (explaining how an efficient tax policy "[does] not distort or influence investment or business decisions").

economists dislike place-based policies because such policies often disrupt economic behavior.[100] And while legislators must strike a balance among equity, efficiency, and administrability, they should nonetheless try to maximize the efficiencies of tax policy when possible.[101]

The Opportunity Act is inefficient in many ways. First, if "efficient" tax policy is defined as one that does not influence investment or business decisions, the Opportunity Act is inefficient on its face because it was designed to alter the investing behavior of individuals and companies.[102] Employing a second definition of "efficient"—whether a tax policy actually benefits its intended beneficiaries—the Opportunity Act is inefficient because the Act's current structure appears to focus more on giving benefits to investors than improving the impoverished areas it was meant to help.[103]

This section will explore how the Opportunity Act both disrupts investing behaviors to direct investment to (non-)impoverished communities and, more tragically, incentivizes behavior that reduces the benefits of those investments.

1. Disrupting Investing Behavior

An investor's ideal investment would be a low-risk venture that offers a high return.[104] Realistically, however, risk and reward generally go hand-in-hand, with low-risk investments offering lower returns and high-risk investments offering higher returns.

Applying this framework to underdeveloped communities, investors sensibly perceive the worst of all investment situations: high risk and low returns. Therefore, without the Opportunity Act, investors would shy away from investing in the impoverished areas that the Act

100. Matias Busso, Jesse Gregory & Patrick Kline, *Assessing the Incidence and Efficiency of a Prominent Place Based Policy*, 103 AM. ECON. REV. 897, 897 (2013) (noting that economists believe place-based policies "generate large distortions in economic behavior").

101. *But see* HANNA, *supra* note 86, at 39 (pointing out that "inefficiency [has been] desired by the United States" in limited tax policy contexts).

102. Bennett, *supra* note 80, at 260 ("When there is a legislatively established tax incentive to bring business into one zone rather than another, the choice of where an investor might place his or her business is likely affected.").

103. *See* HANNA, *supra* note 86, at 39.

104. *See* Audrey E. Abate, Note, *Qualified Opportunity Funds: Private Equity Exemptions from Public Responsibility*, 15 BROOK. J. CORP. FIN. & COM. L. 421, 427 (2021) ("In an economic market, capital flows straight to the lowest-risk, highest return environment . . . .").

targets.[105] Prior to the Opportunity Act, Adam Smith's "invisible hand" was not driving investments towards impoverished areas.

Not oblivious to private industry's investment tendencies, Congress structured a tax policy that would reduce, if not offset, the extra risks and costs involved in investing in underserved communities. Introducing additional tax incentives, Congress hoped that it could encourage private sector investment into America's most distressed localities.[106]

Capital gain deferral,[107] basis increases,[108] and gain exclusion[109] led investors to deviate from their regular investment decisions. People with appreciated capital assets are incentivized to realize those capital gains and roll them into QOF investments because the taxes thereon can be deferred.[110] These same people are incentivized to lock their capital gain investments in QOFs for at least five or seven years to receive up to a fifteen percent reduction and potentially more than ten years to receive QOF gains exclusion.[111] Through this structure,

105. *See* Arda Setrakian, Comment, *If You Need Me, Call Me: The Importance and Means of Matching Opportunity Zone Investment with Community Wants and Needs*, 51 SETON HALL L. REV. 1279, 1306-07 (2021) ("A place that is already being developed arguably poses fewer hurdles and less risk to opportunity zone investors. It may not require so much legwork, such as research, navigating the political landscape, obtaining permits, and other risk-laden barriers to entry inherent in such activities."); *see, e.g.*, Michael Neiman, Comment, *Qualified Opportunity Zones—How Active Participation and Complementary Legislation Can Help States Develop Their Distressed Communities*, 48 CAP. U. L. REV. 457, 475–76 (2020).

106. Setrakian, *supra* note 105, at 1279 (discussing how Congress was looking to "spur efforts by the private sector to revitalize and develop economically distressed communities . . . . ").

107. I.R.C. §§ 1400Z-2(a), (b)(1).

108. I.R.C. § 1400Z-2(b)(2).

109. I.R.C. § 1400Z-2(c).

110. This tax deferral lasts until either a realization event in the investment or December 31, 2026, whichever is earlier. Investors who rolled their capital gains into QOFs at the Act's inception subsequently received ten years of deferral. I.R.C. § 1400Z-2(b)(1).

111. I.R.C. §§ 1400Z-2(b)(2)(B), (c). This incentive caused somewhat of a scramble towards the middle and end of 2019, since after 2019 the fifteen percent basis reduction would become unavailable. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 25; *see also* Lydia DePillis, A *'Mind Boggling' Tax Break was Meant to Help the Poor. But Trendy Areas are Winning Too*, CNN (June 14, 2019, 8:32 AM), https://www.cnn.com/2019/06/14/economy/opportunity-zones-investing-los-angeles/index.html [https://perma.cc/TSK8-H8AW] ("[T]he way the Opportunity Zones have been set up, both investors and the people trying to attract them face a deadline. The value of the tax break starts to decline after the end of 2019. Even though it still has value in future years, fund managers seeking to maximize their return are prospecting deals that are shovel-ready, low risk and straightforward."). *See* Sidle, *supra* note 12, at 160 (discussing how the Opportunity Act "is the only part of the tax code where an investor could fully write off capital gains taxes."); *see also* LOWRY & MARPLES, *supra* note 32, at 8 (discussing how the Congressional Research Service said, the gain

Congress intended to "unlock" investments in less socially productive assets and "lock" them into more socially productive ones.[112] Notably, if the enterprise experiences a loss, the investors can still recognize (or accrue, if they are unable to recognize) a tax loss.[113]

The Act creates an enticing investment opportunity for investors. In the event a QOF is unprofitable, investors' loss is partially subsidized via the deferral, increase in basis, and a typical loss deduction. On the other hand, in the event a QOF is profitable, investors still receive the deferral and increase in basis and are not taxed on the gains from the investment.[114]

Given these powerful incentives, it should come as no surprise that QOFs have received investment dollars. A recent GAO report revealed that through 2019 over 6,000 QOFs invested approximately $29 billion. A majority of QOFs surveyed cited the Act's tax breaks as the deciding factor for their investments.[115] Additionally, by 2021 over 200 QOFs were established to raise and invest $57 billion.[116]

Despite changing investment behaviors to send money to low-wealth communities, the Act did not redirect nearly as much as was expected. As of the end of 2021, QOFs had raised only one-fourth of the funding that Congress originally anticipated.[117] Moreover, other

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exclusion is "[t]he largest tax benefit associated with [the Opportunity Act's] tax incentives.").

112. JOINT COMM. ON TAX'N, 115TH CONG., QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 6 (June 19, 2019).

113. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 23.

114. In addition to the tax benefits offered by the Opportunity Act, the Act does not prohibit claiming overlapping tax benefits, such as the New Markets Tax Credit and state and local incentives. Investors can "stack" benefits. *Id.* at 30.

115. *Id.* at 22, 36. At least six of the eighteen surveyed QOFs did not cite the Act's tax breaks as their primary purpose for investments, perhaps because the tax breaks were not too attractive to them, because they planned on making their investments prior to the Act, or because they were motivated to generate positive social impacts no matter the cost. *Id.* For example, four of the QOFs surveyed by the GAO reported they would have invested in a QOZ regardless. *Id.* at 22. Some QOFs mentioned they needed the QOZ project to be "sound" before investing. *Id.* It is unclear whether the cited QOFs require QOZ projects to be as "sound" as traditional investments, but it is clear that at least some investors did not believe the Act's tax incentives were powerful enough to turn "unsound" QOZ projects into profitable enterprises that are worth their time and money. One QOF insightfully explained that, as opposed to the NMTC and Low-Income Housing Tax Credit (LIHTC), the value of the Opportunity Act's program stems from the cash flow and capital gains tax benefits, not tax credits. *Id.* at 22–23.

116. *See* Abate, *supra* note 104, at 422.

117. Treasury Secretary Steven Mnuchin expected Opportunity Zones to attract over $100 billion, but as of the end of 2021, only about $24.4 billion had been invested into QOFs. Sidle, *supra* note 12, at 143–44; Michael Novogradac, *Opportunity Funds Investment Report: $15 Billion in Equity by End of 2020*, NOVOGRADAC (Feb. 3, 2021,

taxpayers may never consider making investments in QOFs without a profitable enterprise.[118] This possibly explains why, as of October 2019, QOFs had not raised even "fifteen percent of their targeted funding."[119]

At the same time, however, it appears that the Act has been at least moderately successful at drawing capital into QOZs. Even still, investments may be going to QOZs for reasons other than the Act's tax incentives, such as true profitability and potential philanthropic efforts.[120]

Since the tax incentives are time-based, less investment will occur with each subsequent year of the Act's life.[121] As time-based tax incentives are no longer available to investors, the overall investment will likely decrease.[122]

12:00 AM), https://www.novoco.com/notes-from-novogradac/opportunity-funds-investment-report-15-billion-equity-end-2020 [https://perma.cc/9BW5-QFRV]. Note, however, that Novogradac collects data only from QOFs who offer it voluntarily, SEC filings, and other public sources, and that Novogradac does not include private or proprietary funds; for these reasons, Novogradac readily admits that other reports indicate the total amount of equity raised is three to four times of what Novogradac's estimates. Tax Credit Tuesday, *What You Need to Know About the $7 Billion in OZ Investment Since Mid-2021*, NOVOGRADAC, at 01:49 (Feb. 15, 2022) [hereinafter Novogradac Podcast] https://www.novoco.com/podcast/feb-15-2022-what-you-need-know-about-7-billion-oz-investment-mid-2021 [https://perma.cc/M7BJ-Y79H]; *see also* Blake Christian & Austin Bowen, *Opportunity Zone Program Still Plenty Viable for Clients with Gains*, TAX ADVISER (Mar. 17, 2022), https://www.thetaxadviser.com/newsletters/2022/mar/opportunity-zone-program-still-viable-clients-with-gains.html [https://perma.cc/JW22-L7BY].

118. Abate, *supra* note 104, at 427.

119. Sidle, *supra* note 12, at 146.

120. *See supra* note 62 and accompanying text.

121. Because the tax reduction incentive becomes unavailable after 2021, some believe that investments in QOFs will slow after the end of 2021, or that the investment "window" will close at the end of 2021. Carlos Jose Rodriguez, Sr., *As Opportunity Zone Window Closes, the Case for Investment Is Stronger Than Ever*, FORBES (Oct. 5, 2021, 7:00 AM), https://www.forbes.com/sites/forbesbizcouncil/2021/10/05/as-opportunity-zone-window-closes-the-case-for-investment-is-stronger-than-ever/?sh=E9e825f55f51 [https://perma.cc/W7FY-JAQX]. With that said, even without President Biden's proposed capital gains tax hikes, the TCJA's expiration at the end of 2025 might incentivize wealthy taxpayers to invest in QOFs merely for the deferral benefit. But even then, the value of deferral decreases each passing year until it reaches zero in 2026. Jeff Stimpson, *Tax Landscape Will Shift Despite Biden Tax Reform Failures*, FIN. ADVISOR (Mar. 1, 2022), https://www.fa-mag.com/news/tax-landscape-shift-despite-biden-tax-reform-failures-66598.html [https://perma.cc/99EJ-JJRY]; *see also* Christian & Bowen, *supra* note 117 (explaining that federal and state taxes are expected to rise in coming years, along with increasing inflation rates and diminishing tax expenditures in the Code).

122. JOINT COMM. ON TAX'N, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT", JCX-67-17 (Dec. 18, 2018).

The Opportunity Act's tax breaks may not draw as much private capital into underserved communities as expected, and these tax breaks will cost the government billions. Even worse, the capital that has been invested in these communities is often allocated to socially unproductive purposes, as discussed below. Although the Act's purpose was to revitalize economically distressed economies, it lacked the efficiency to do so.

2. Counterproductive Investments

Although the spirit of the Opportunity Act was to uplift impoverished areas, the application of the Act may not uplift as much as expected. The nature of the problem is captured in a statement made by The Brookings Institution: "[f]ew federal policies feature such large, uncapped tax subsidies with so few limits on how those subsidies can be used."[123] Although this statement was made before the Treasury and the IRS issued final regulations in 2019,[124] the Act nevertheless continues to bear the potential to reward socially unproductive, and occasionally even harmful, investments.[125]

This section will address three ways in which the Opportunity Act created opportunity—not for economically distressed communities—but for opportunistic behaviors. First, Congress gave too much leeway to State CEOs when nominating Eligible Tracts as QOZs. Second, Congress established inadequate limits on the QOZ projects that QOFs could invest in, and third, Congress incentivized investors to be removed from the QOZ projects that their investments would fund.

a. Nominating Eligible Tracts.

State CEOs had few restrictions when nominating Eligible Tracts as QOZs (the Nomination Process). As explained in Part I.B, State CEOs had little direction from Congress during the Nomination Process, aside from receiving the 2011 census poverty rates for the Eligible Tracts. Notably, the Eligible Tracts included over half of all U.S. neighborhoods, which left the process vulnerable to abuse.[126]

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123. GELFOND & LOONEY, *supra* note 5, at 1.
124. Press Release, U.S. Dep't of the Treasury, Treasury and IRS Issue Final Regulations on Opportunity Zones (Dec. 19, 2019), https://home.treasury.gov/news/press-releases/sm864 [https://perma.cc/E28A-JJN9].
125. *See infra* Part II.B.2.b.
126. *See* Bennett, *supra* note 80, at 269 ("This vagueness can be abused in a number of ways: (a) tracts can be in economically viable areas already with a small amount of housing that is disproportionately low-income; (b) tracts can be immediately adjacent to an already economically strong tract; or (c) a tract can be within an economically

To their credit, some State CEOs nominated impoverished areas by looking at various criteria, soliciting suggestions from constituents, evaluating employment statuses, and consulting with tribal or local government officials.[127] Such diligence shown by State CEOs likely explains why states generally selected distressed communities.[128] Nonetheless, the wide discretion left to State CEOs inevitably meant that the selection process did not effectively target the neediest communities.

States often overlooked the most distressed communities in favor of moderately distressed communities.[129] Congress should have anticipated this result and safeguarded the Nomination Process by further limiting the Eligible Tracts so that only the most distressed areas were available for nomination. Instead, the Nomination Process was largely left solely to state leaders[130] who had state-tailored motives to nominate tracts that affected their unique goals for economic growth and development.[131]

A cursory review of QOZs reveals that many State CEOs selected healthier and more attractive Eligible Tracts instead of exclusively poor ones. In the same way that real estate developers motivated by the LIHTC selected neighborhoods to maximize their prospective tax credits, many State CEOs nominated Eligible Tracts to

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strong metropolitan area and simply below the median income in that area."); GELFOND & LOONEY, *supra* note 5, at 3 ("Nationwide, 45 percent of all neighborhoods qualified to be selected based on their low-income status and a total of 57 percent qualified considering other criteria").

127. Victoria Lee, Note, *Opportunity Without Reach: The Problems with the Opportunity Zone Program and the Need for Clarification, Oversight, and Regulation*, 47 FORDHAM URB. L.J. 117, 128 (2019); Kathleen M. Nilles, *Making Opportunity Zones Work for Tribal Economic Development*, FED. RESERVE BANK MINNEAPOLIS (Sept. 19, 2018), https://www.minneapolisfed.org/article/2018/making-opportunity-zones-work-for-tribal-economic-development [https://perma.cc/QHG2-4Y5C].

128. LOWRY & MARPLES, *supra* note 32, at 7 (stating that "[d]esignated tracks . . . have lower incomes, higher poverty rates, and higher unemployment rates than eligible non-designated tracts . . . ."); GELFOND & LOONEY, *supra* note 5, at 3 (discussing how after taking into account average poverty rates, child poverty, educational attainment, and other factors, the report found that, "[o]n average, states selected relatively disadvantaged areas for their Opportunity Zones.").

129. GELFOND & LOONEY, *supra* note 5, at 5 ("[T]here was clearly opportunity for improvement [because] [s]tates could have targeted more of their [QOZs] to places in deeper distress.").

130. Bennett, *supra* note 80, at 271 (explaining how nomination was left "to the discretion of state executives" who each have different development and investment priorities).

131. Looney, *supra* note 52.

maximize prospective in-state investment generally.[132] Some Eligible Tracts met the poverty rate only because their populations were one-third college students—these areas were especially ripe for business opportunities, yet do not fit the mold of the QOZs imagined by the Act's creators.[133] Other QOZs, which will not be discussed in detail here, were clearly not distressed but were nevertheless chosen to amplify an already sound business deal,[134] to subsidize a local government's preplanned development expenses,[135] or to enhance the economies of healthy communities rather than underserved communities.[136] This discretion of state leaders has led to less-than-desirable outcomes in the Nomination Process.

Exemplifying the potential for abuse in the Nomination Process was the designation of Storey County as a QOZ. Although Storey County fell outside of the already generous limits of the Eligible Tract requirements, Nevada politicians and investors placed pressure on the Treasury Department to allow investments into Storey County to qualify for tax benefits under the Opportunity Act.[137] These gamesman-

132. GELFOND & LOONEY, *supra* note 5, at 8 (citing Nathaniel Baum-Snow & Justin Marion, The *Effects of Low Income Housing Tax Credit Developments on Neighborhoods*, 93 J. PUB. ECON. 654 (2009)) (saying that many developers picked neighborhoods "based on the value of the tax credits they [were] eligible to receive.").

133. Looney, *supra* note 52; GELFOND & LOONEY, *supra* note 5, at 3 ("[M]any states elected to use the program in high price appreciation areas [which is] a boon to investors hoping to reap the tax benefits of their capital gains.").

134. *See generally* Sidle, *supra* note 12 (citations omitted) (citing Jeff Ernsthausen & Justin Elliott, *Opportunity Zones are Meant to Spur New Investment in Poor Areas. But Port Covington Could Get a Tax Break*, *BALT. FISHBOWL* (June 19, 2019), https://baltimorefishbowl.com/stories/opportunity-zones-are-meant-to-spur-new-investment-in-poor-areas-but-port-covington-could-get-a-tax-break/ [https://perma.cc/BG7X-6RAJ]) ("[B]y choosing Port Covington [the wealthy area], Maryland excluded Brooklyn, which had 'a median family income one-fifth that of Port Covington.' The justification was given by a business developer who intended to use Port Covington for business purposes even before the Opportunity Act was enacted.").

135. Looney, *supra* note 48 ("By designating [once-poor yet now gentrified] areas as Opportunity Zones, the D.C. government can wipe out the tax bill that would otherwise apply on the sale of those developments.").

136. Lee, *supra* note 127, at 131–35 ("Fresno County [which received at least one QOZ designation] is a place that . . . has a strong industrial base, affordable real estate, highway foot-traffic, and a 'steady supply of educated workers'"); DePillis, *supra* note 111 (concluding that wealthy towns, like Hollywood, apparently were receiving the bulk of Opportunity Act investment "rather than places like Census tract 5425.02, better known as Compton, where the median household income is $35,457, barely half of the national median, [and where nearly] 35 percent of people . . . live below the poverty line—almost triple the national poverty rate.").

137. Damian Paletta, *After Nevada GOP Push, Treasury Changed Lucrative Policy Benefiting One County*, WASH. POST (June 22, 2018, 2:01 PM), https://www.washingtonpost.com/business/economy/after-nevada-gop-push-treasury-quietly-

ship opportunities would be limited if the requirements for Eligible Tracts and the Nomination Process were more refined.

Additionally, State CEOs had a limited number of nominations. A nomination for a healthy (or at least non-distressed) community could be viewed as a nomination against a distressed one.[138] Further perverting State CEOs' incentives to direct private investments to truly distressed communities was the fact that some wealthy communities that qualified as neither LICs nor Contiguous Areas qualified as Eligible Tracts only because of typographic errors.[139]

Although the Opportunity Act certainly subsidizes some investments into areas that need it, the Act is inefficient because it does not ensure that its incentives flow exclusively to residents of impoverished areas.[140]

b. The Broad Scope of QOZ Projects.

While it is certainly inefficient that the Act's tax benefits are channeled to relatively healthy communities instead of the Act's intended beneficiaries, distressed communities, this is not the only inefficiency observed. The types of business ventures in which QOFs are investing also highlight the Act's inefficiencies.

To qualify for its tax benefits, the Opportunity Act requires QOFs to invest in businesses with certain features, including the existence of QOZ Business Property.[141] Yet the Act hardly limits the nature of the

changed-policy-benefiting-one-county/2018/06/22/d142acfc-74c5-11e8-b4b7-308400242c2e_story.html [https://perma.cc/TPP3-AGAL].

138. Lee, *supra* note 127, at 135 ("[C]hanneling funds into projects that would have inevitably occurred regardless of a federal tax incentive draws budgeted funds away from other low-income tracts that did not make the final cut . . . ."); Trivedi, *supra* note 92, at 770 ("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."). This logic assumes that there existed enough truly poor Eligible Tracts in each state that State CEOs could meet the twenty-five percent requirement by exclusively selecting them.

139. Ernsthausen & Elliott, *supra* note 134 (explaining that Port Covington qualified as an Eligible Tract only because a next-door neighborhood was previously selected as an EZ and the digital identifier of said neighborhood erroneously overlapped with a "sliver of parking lot" located in Port Covington).

140. *See* Lee, *supra* note 127, at 136 ("Channeling funding into areas that are already undergoing revitalization may also end up harming the very individuals the Opportunity Zone Program seeks to aid."); GELFOND & LOONEY, *supra* note 5, at 1 ("[P]oor geographic targeting reduces the impact of the program and limits the benefits that accrue to poor residents.").

141. *See supra* Part I.B.2.

business ventures in which QOFs invest, i.e., the QOZ Projects.[142] In fact, the Act never once requires that QOZ Projects benefit QOZs.[143]

Notably, the linchpin of QOF status, and thus obtaining the Act's tax benefits—QOZ Business Property—is defined in the Code without reference to whether or to what extent it either directly or indirectly provides a social or economic benefit to the QOZ in which it is located.[144]

As mentioned in Part I.B.2, QOFs are not required to apply for QOF status nor seek approval before investing in QOZ Projects; all QOFs need to do is self-certify as a QOF with philanthropic motives on a Form 8996.[145] However, because the Opportunity Act provides no accountability mechanism for taxpayers to ensure that their investments actually benefit QOZs and the purposes they serve,[146] QOFs may focus on establishing ventures created solely to achieve high profits.[147]

142. Among the few limitations are that QOFs cannot invest in "a golf course, country club, massage parlor, hot tub or suntan facility, racetrack, or other facility used for gambling, or store whose principal business is the sale of alcoholic beverages for consumption off premises." JOINT COMM. ON TAX'N, 115TH CONG., QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 38 (June 19, 2019).

143. Abate, *supra* note 104, at 428 (referring to benefitting QOZs as a "duty"). The 115th Congress may have believed that these two objectives—generating a profitable investment and revitalizing underserved communities—were one in the same, but history indicates that past congresses recognized they often are not. For example, in 1994 the federal government structured the Community Development Financial Institutions Fund (CDFI Fund) to draw private capital into economically distressed areas by giving economic rewards in exchange for following a plan that could benefit such areas. Like the Opportunity Act, the CDFI Fund's core purpose was to incentivize "activity that private-sector investors would not otherwise engage in." SEAN LOWRY, CONG. RSCH. SERV., R42770, COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFI) FUND: PROGRAMS AND POLICY ISSUES 24 (2018). Unlike the Opportunity Act, however, the CDFI Fund awarded government incentives to investors only after they presented adequate plans to revitalize the communities in which they would invest. This suggests the federal government was aware of the reality that, if left unchecked, private investors may try to claim government incentives without truly qualifying for them.

144. I.R.C. § 1400Z-2(d)(2)(D).

145. Although QOFs need to structure themselves correctly (i.e., meet the Ninety-Percent Rule), for reasons explained in Part I.B.2 and those touched on in this section, this structure offers no guarantee that QOFs will help QOZ residents.

146. Morgan Simon, *Opportunity Zones: We're Doing It Wrong*, FORBES (Sep. 3, 2019, 1:44 PM), https://www.forbes.com/sites/morgansimon/2019/09/03/opportunity-zones-were-doing-it-wrong/ [https://perma.cc/7LX3-663J].

147. At least one scholar predicted this result, believing that investors would be drawn toward "projects with more fixed return, such as market rate housing, as well as hotels and other commercial real estate projects . . . ." De Barbieri, *supra* note 83, at 140.

Fortunately, data collected on the impact of the Opportunity Act captures the good it has done for various QOZs. With respect to job growth, over 280,000 jobs in QOZs have been created that span a variety of sectors and recruit low-skill workers.[148] Moreover, housing prices have experienced an increase in QOZs and some adjacent areas, thereby boosting homeowner equity.[149] Also, private funds are purportedly beginning to take advantage of the Opportunity Act, implicating job growth in QOZs.[150] Taken together, the Act's powerful incentives appear to be creating something of the positive impact Congress originally envisioned, but the Act's structure does not adequately ensure that qualifying investments always help QOZs.

Many Opportunity Act investors have evidently made self-benefiting investments that incidentally leave QOZ residents unassisted or worse off than before. A GAO report released near the end of 2021 indicated that Opportunity Act investors have invested in "commercial real estate development, multifamily housing development, agricultural land development, renewable energy businesses, and hotel development."[151] Certainly, these investments—particularly investments in hospitality, renewable energy, and operating businesses—can lift QOZ residents' quality of life by giving them access to jobs, and potentially better paying ones at that. However, several sources reveal that the QOZ Projects that investors are primarily funding may be less helpful to QOZ residents than the ones that remain unfunded.[152]

Given that many State CEOs nominated Eligible Tracts experiencing property appreciation,[153] investors are economically driven to

148. Christian & Bowen, *supra* note 117 (citing Alina Arefeva, Morris A. Davis, Andra C. Ghent & Minseon Park, *Job Growth from Opportunity Zones*, BROOKINGS at 1, 22, 25 (Feb. 19, 2021), https://www.brookings.edu/wp-content/uploads/2021/01/Arefeva-Davis-Ghent-Park-2020-Job-Growth-from-Opportunity-Zones.pdf).

149. *Id*. (citing Press Release, U.S. Dep't of Hous. and Urb. Dev., New Report Shows Opportunity Zones on Track to Lift One Million Americans out of Poverty (Aug. 25, 2020), https://archives.hud.gov/news/2020/pr20-131.cfm).

150. *Id*.

151. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 19.

152. Novogradac Podcast, *supra* note 17; *see also* EIG Opportunity Zones Activity Map, ECON. INNOVATION GRP., https://eig.org/oz-activity-map (last accessed Feb. 28, 2022) (depicting that most investments are in real estate, whether that be residential, commercial, or mixed use); Simon, *supra* note 146 ("In the worst cases, OZ projects can actually contribute to the problems of underpaid jobs, gentrification, and disempowerment, instead of offering a remedy. Currently, a Ritz Carlton is in the plans for a Portland OZ"); Sidle, *supra* note 12, at 159 ("Critics believe the Port Covington project is going to benefit high-income individuals at the expense of . . . low-income communities [as it] is focused towards millennials, and plans to feature offices, a hotel, apartments, and shopping, in addition to the new Under Armour headquarters.").

153. Looney, *supra* note 52.

allocate investments towards real estate.[154] The Opportunity Act's structure also makes real estate a desirable investment because its Ninety Percent Rule is readily satisfied via real estate properties.[155] Thus, very little gamesmanship is necessary, if at all, to access a constant and increasing source of revenue. Within the context of the Opportunity Act, the low-risk, high-profit combination that real estate offers creates a highly attractive option for the reasonable investor.

While real estate investments would be ideal if residents in underserved communities benefitted alongside investors, this is often not the case. Though providing nicer and expectedly healthier living situations,[156] some scholars claim that investments in residential real estate result in higher rents and cost of living,[157] especially in gentrifying areas, which many QOZs become.[158] Because more than half of renters in QOZs spend at least thirty percent of their household income on rent,[159] real estate investments, which are the most common QOF investments,[160] may lead to displacement.

Moreover, the incentive to invest in real estate draws private capital away from projects that could otherwise increase employment

154. Ofer Eldar & Chelsea Garber, *Opportunity Zones: A Program in Search of a Purpose*, 102 B.U. L. Rev. 1397, 1429 (2022) (discussing the empirical analysis conducted to concluded that the Opportunity Act has pushed significant investment into real estate rather than other projects).

155. This is similar to how the NMTC's seven-year structure "tilts [investments] towards real estate." BERNSTEIN & HASSETT, *supra* note 1, at 10.

156. Government programs like those in President Biden's Build Back Better Act can aim to create housing that "is not only safe and habitable but healthier and more energy efficient as well." Press Release, The White House, President Biden Announces the Build Back Better Framework (Oct. 28, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/28/president-biden-announces-the-build-back-better-framework/ [https://perma.cc/R64A-LG68].

157. Lee, *supra* note 127, at 136–37; *see also* Trivedi, *supra* note 92, at 770 ("The investments [that investors] 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.").

158. Lee, *supra* note 127, at 136–37 (recognizing that investors will heavily invest in real estate in gentrifying QOZs and describing the Opportunity Act's tax incentives as a "subsidy for gentrification."); *see* Looney, supra note 52 ("[M]any states selected areas with higher-than-average home price appreciation—one indication of gentrification.").

159. *Facts & Figures*, ECON. INNOVATION GRP., https://eig.org/opportunityzones/facts-and-figures#sec5 (last accessed on Feb. 28, 2022).

160. Novogradac Podcast, *supra* note 117 (discussing how residential real estate investments constitute nearly half of all QOF investments according to one source and, combined with commercial real estate investments, they constitute nearly ninety percent of all QOF investments).

rates and stimulate economic growth.[161] However, investments in operating businesses constituted less than two percent of QOF investment, according to one source.[162] Although investments in operating businesses, especially small businesses found in QOZs, are expectedly smaller than those made in real estate projects, the apparent disparity between real estate investments and operating business investments is likely more reflective of investor behavior than project size.

Because the Opportunity Act does not require investment in exclusively socially or economically productive enterprises, such that any resulting positive social impact relies exclusively on QOFs' commitment to philanthropy, less-philanthropic investors come to establish neutral or inadvertently hostile ventures that effectively exacerbate, rather than ameliorate, issues faced by economically distressed communities.

c. *Investors are Incentivized to be Removed from their Investments.*

QOFs can choose to be removed from operating businesses. The Opportunity Act offers two basic investment structures: one-tier QOFs (One-Tiers) and two-tier QOFs (Two-Tiers). One-Tiers are QOFs that are their own operating businesses. In contrast, Two-Tiers are QOFs that own stock or partnership interests in operating businesses that meet the definition of QOZ Businesses. Because the Act does not require Two-Tiers to be involved in their underlying QOZ Businesses, they are able to distance themselves from such businesses.

Aside from those involved in real estate,[163] QOFs will likely be formed as Two-Tiers because QOFs are incentivized to be removed from QOZ Businesses. Only a fraction of the investments into QOF's need to be used in a QOZ for the investors to still retain all of the tax benefits of the Act. However, Two-Tiers are able to allocate even less of their investments to QOZs than One-Tiers since Two-Tiers essentially invest in QOZ Businesses—which can have QOZ Business Property constitute as little as seventy percent of their total tangible

161. *See* De Barbieri, *supra* note 83, at 140–41 ("Investment in job creation and business growth in particular could do much to benefit residents who have lived and worked in a zone for years.").

162. Novogradac Podcast, *supra* note 117.

163. For reasons explained in this Part II.B.2.c, investors have a strong incentive to be actively involved in managing operating businesses dealing with real estate. Important to note is that the Act prohibits operating businesses from requiring their consumers to enter into triple-net leases, so one-tier QOFs operating a rental real estate group may feel incentivized to actively manage costs. JOINT COMM. ON TAX'N, 115TH CONG., QUALIFIED OPPORTUNITY ZONES: AN OVERVIEW, at 29 (June 19, 2019).

property—while One-Tiers, by definition, invest exclusively in QOZ Business Property. The economic flexibility granted to Two-Tiers under this statutory framework incentivizes investors to prefer Two-Tiers.[164] Also, because investments in small businesses in QOZs are riskier and offer a lower prospective return than other investments,[165] QOFs will likely prefer a two-tier structure because, unlike One-Tiers, Two-Tiers can more adequately diversify risk. Also, Two-Tiers are preferable because QOZ Businesses may count tangible property as QOZ Business Property even if they have not used it in a QOZ for up to five years.[166]

These incentives have important implications. First, without any requirement to the contrary, QOFs will likely form as Two-Tiers to be removed from the management of QOZ operating businesses, since involvement drains resources that could be invested elsewhere. Second, because Two-Tiers can avoid being personally invested in the success of their underlying QOZ Businesses and would prefer to keep it that way, Two-Tiers will likely invest in relatively more lucrative QOZ operating businesses. Consequently, two-tier structures in the Opportunity Act may be leading QOFs to invest in operating businesses that would have received investment even without the Opportunity Act's tax incentives. If this is true, impoverished parties in need of funding and sophisticated management expertise will again be left on the margins.

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164. Due to the Ninety Percent Rule, both One-Tiers and Two-Tiers can allocate ten percent of their funds to traditional investments, but Two-Tiers have more opportunities to divert their funds to non-QOZ investments. Assuming that Two-Tiers allocate ten percent of their funds to traditional investments, they will be left with only ninety percent of their funds to purchase QOZ Stock and/or QOZ Partnership Interests, which need to be in QOZ Businesses. As reviewed above, QOZ Businesses only need seventy percent of their tangible property to be QOZ Business Property. JOINT COMM. ON TAX'N, *supra* note 61. Of the ninety percent of QOF Funds invested in a QOZ Business, only seventy percent of such investments need to be spent on QOZ Business Property. The cumulative effect of the Ninety Percent Rule and the seventy percent requirement in QOZ Businesses is that QOFs need to spend only sixty-three percent of their funds on QOZ Business Property. Even then, as reviewed above, QOZ Business Property needs to be used only sixty-three percent of the time in a QOZ. I.R.S. F.A.Q., *supra* note 59. If a QOF allocated only sixty-three percent of its funds to QOZ Business Property, and if a QOZ Business used that property only sixty-three percent of the time in the QOZ, a Two-Tier could theoretically employ only forty percent of its investments in a QOZ and still receive the Act's tax benefits. One-Tiers, on the other hand, do not have the flexibility of owning as little as seventy percent of QOZ Business Property through QOZ Stock and QOZ Partnership Interest; all of its QOZ property must be QOZ Business Property.

165. *See* De Barbieri, *supra* note 83, at 140 ("Small businesses are less likely to receive investor attention given the emphasis on real estate from the investment community.").

166. *See supra* Part I.B.2.

The Opportunity Act is inefficient because it was designed to manipulate investor behavior. The Act does not only impact the economic behavior of investors, but it also lacks the efficiencies needed to benefit the Act's intended beneficiaries.

C. Administrability

The Opportunity Act is difficult to administer. The Act has grown quite complex for both the private industry to follow and the IRS to monitor. With less than 3,000 words, the Opportunity Act, which meant to give flexibility, was vague and hard for practitioners to apply. Though the IRS issued and finalized 544 pages of regulations at the end of 2019 (Final Regulations)[167] in response to investor demands for clarification,[168] these have only made the Act more difficult to administer due to the Final Regulations' complexity.[169] Developing a conceptual understanding of one of the Final Regulations, let alone how they interact with each other, is nothing short of a feat, and incorporating them into real-world applications is even more difficult.

1. Complexity for Private Industry

The Opportunity Act's regulatory developments have increasingly deterred investors from claiming the Act's tax benefits. Taxpayers and scholars initially found the Opportunity Act less restrictive than other capital gain deferral provisions[170] and therefore created a lower administrative burden. Yet the lack of restrictions followed by the complexity of the Final Regulations created a significant burden on the private industry.

Many QOFs and investors complain that the Act imposes a short timeline for investing capital gains into QOFs. Although exceptions have been made for various circumstances, including for gains realized by pass-through entities,[171] COVID-19,[172] and Two-Tiers that es-

167. I.R.S. News Release IR-2019-212 (Dec. 19, 2019).

168. Lee, *supra* note 127, at 130 (noting these demands were made by over two hundred investors and civic leaders); *see, e.g.*, Rev. Rul. 2018-29; 2018-45 IRB 765 (explaining how to "substantially improve" business property).

169. De Barbieri, *supra* note 83, at 138–39.

170. Such as Section 1031 Like-Kind Exchanges and the NMTC program. *See* Lester et al., *supra* note 16, at 226–28 ("[T]he [Opportunity Act] is structurally less rigid than predecessor policies to accommodate a wider range of investment opportunities.").

171. *Id.* at 6 n.7 (explaining how pass-through entities have 180 days from when they file their tax return to invest in a QOF).

172. *Id.* at 6 ("COVID-19 investors could have up to 544 days to invest eligible gains" if they realized them in October 2019).

tablish a QOZ Business,[173] many investors still find this window restricting.[174]

Other timelines are also confusing and burdensome. For example, once investments have been made into QOFs, some QOFs must "substantially improve"[175] their QOZ Business Property within thirty months, but a GAO report found that QOF representatives believe that period is too short.[176] Also, deadlines for obtaining the ten percent capital gains tax reduction and the fifteen percent capital gains tax reduction implicitly forced investors to invest in 2019—when legislation and rules surrounding the Act were still unclear.[177] What many had referred to as the Act's flexibility was instead viewed as the Act's unpredictability.

Another burdensome requirement of the Act is that taxpayers recognize their deferred capital gains no later than December 31, 2026.[178] Because taxpayers can exclude the appreciated gain on their QOF Interests only after holding them for at least ten years, taxpayers investing in QOFs after 2017, especially the less wealthy investors, will predictably struggle to have the liquidity to pay taxes on the originally deferred capital gains.[179] Considering that the GAO found that fourteen out of the fifty U.S. states believed the Act was complex for even professionals,[180] the difficulties reviewed herein present significant obstacles for the private industry and expectedly deter participation.[181]

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173. *Id.* at 25 ("By placing the [invested] capital into this business the funds are then able to hold those working capital funds without investing them in [QOZ] property for up to 31 months provided, among other things, they have a written plan for how they intend to deploy that capital and then execute that plan.").

174. Adding to the complexity is the fact that the GAO believes investors have 180 days upon realization—not recognition—of capital gains.

175. I.R.C. § 1400Z-2(d)(2)(D)(ii).

176. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 24–25.

177. *Id.* at 25 (The deadlines "created some pressure to accelerate fundraising in 2019—a time of uncertainty before the Opportunity Zones tax incentive rules had been finalized . . . .").

178. I.R.C. § 1400Z-2(b). Although proposed legislation would push back this date. H.R. 7467, 117th Cong. § 301(a) (2022).

179. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 25–26; Lester et al., *supra* note 16.

180. Lester et al., *supra* note 15, at 32 (saying the fourteen states "cited challenges from the [Opportunity Act's] complexity in general, or more specifically, from financial planners', investors', or developers' lack of understanding.").

181. *See, e.g.*, Tashjian, *supra* note 6, at 870 (Prior to the passage of the Small Business Investment Incentive Act, venture capital firms were very hesitant to accept capital from unaccredited investors because they wanted to avoid "being subject to detailed regulations under the 1940 Act" and were unwilling "to try and operate under the 1940 Act as it existed.").

These problems create administrative burdens and costs for QOFs and investors alike.

2. Complexity for the IRS

The Opportunity Act poses as many if not more challenges for the IRS than it does for the private industry. In light of an understaffed IRS,[182] the public's large participation in the Opportunity Act[183] has surely overwhelmed the IRS's capacity. This is specifically because, according to a GAO report, the IRS lacks sufficient resources[184] and proper systems to adequately ensure taxpayer compliance.[185]

182. IRS Budget and Workforce, INTERNAL REV. SERVS., https://www.irs.gov/statistics/irs-budget-and-workforce (last updated May 26, 2022). *See also* Juliana Kaplan & Joseph Zeballos-Roig, *The IRS Is Wildly Understaffed, and it Could Make for a Hellish Tax Season*, BUS. INSIDER (Jan. 29, 2022, 5:30 AM), https://www.businessinsider.com/tax-season-outlook-analysis-difficult-refunds-delayed-irs-understaffed-2022-1 [https://perma.cc/GZC5-3HY9]; The *IRS Doesn't Have What They Need to Serve Americans Well—Congress Can Help*, U.S. DEPT. TREAS. (Apr. 18, 2022), https://home.treasury.gov/news/featured-stories/the-irs-doesnt-have-what-they-need-to-serve-americans-well-congress-can-help [https://perma.cc/82PN-47SV].

183. *See supra* Part II.B.1.

184. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019. Regarding resources, digital transcription is an effective way to monitor taxpayer compliance because it requires less human capital than manual review. However, even incorporating digital transcription reportedly may require IT resources the IRS lacks. So, even though the IRS believes that utilizing transcription would "facilitate enforcement efforts . . . and increase compliance revenue," it is only transcribing some data on Forms 8996 and 8997 starting for taxable year 2021. But even then, the GAO report indicates that this decision is "discretionary" and can be overturned by more pressing concerns. Considering the Act's high cost and the many numbers the IRS will need to track to prevent abuse, such as Investment Basis, QOFs with mixed funds, and claimed basis reductions, these GAO findings are perplexing.

185. Turning to improper systems, the problem is rooted in the kinds of investors the Act attracts and how such investors structure their investments. As Bernstein and Hassett hoped, large institutional investors, in addition to very wealthy individuals, are investing in QOZs. While the amount of capital that institutional investors and high-wealth individuals contribute serves as a boon for their QOZ Projects, these investors structure as partnerships, the monitoring of which gives the IRS an administrative headache. The Large Business and International (LB&I) division within the IRS normally reviews the returns for investors like the wealthy investors, but the IRS has actually delegated the Small Business and Self-Employed (SB/SE) division to oversee compliance for the Opportunity Act. In so doing, the IRS has created an administrative mismatch between wealthy investors and the SB/SE division. Not all Opportunity Act investors constitute wealthy investors, but many do and, on top of it being ill-equipped to supervise wealthy investors in the first place, the SB/SE division has indicated no intent to enhance compliance monitoring procedures for them. U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 43 ("[O]ngoing research into taxpayer compliance with the Opportunity Zones tax incentive rules did not include [high-wealth and high-income individuals and pass-through entities]. Further, according to SB/SE officials overseeing compliance, IRS has no plans to do so.").

These concerns and the others reviewed above may be alleviated by beefing up the IRS workforce.[186] With that said, it is unclear and even doubtful whether the IRS would decide to allocate that funding towards the Opportunity Act, since it has already once decided that the Act is not one of its top priorities. Despite its limited resources and administrative mismatches, as the agency currently stands, the IRS finds itself unable to effectively ensure compliance with the Act.

The equity, efficiency, and administrability analyses presented herein provide a fresh and comprehensive review of the Opportunity Act. The Act has not met expectations: it lacks both vertical and horizontal equity, it is inefficient as a matter of influencing investment and business decisions as well as failing to ensure that its benefits reach low-income QOZ residents, and it presents functional and administrative challenges for private industry and the IRS alike.

Though initially and theoretically lauded by both sides of the aisle, the Opportunity Act suffers from the same challenges as prior place-based policies, which in turn have ineffectively served and sometimes even hurt the very communities the legislation was meant to help. Though the Opportunity Act possesses the potential to draw large amounts of capital into low-income communities,[187] it lacks the structure and systems to ensure the investments are benefiting the communities the Act was meant to serve.[188]

III.
Proposed Solution: True LICs, Transparency, and Non-Real-Estate Investments

This proposal will address three areas in which the Opportunity Act could be reformed to better drive meaningful investment into

186. Chuck Marr, Samantha Jacoby, Jabari Cook & David Reich, *Congress Needs to Take Two Steps to Fund the IRS for the Short and Long Term*, Ctr. on Budget & Pol'y Priorities (Feb. 1, 2022), https://www.cbpp.org/research/federal-tax/congress-needs-to-take-two-steps-to-fund-the-irs-for-the-short-and-long-term [https://perma.cc/ZZV8-947T].

187. In addition to the Act's powerful tax incentives, the Act was designed to invite investment from large institutional investors, unlike prior place-based policies. Bernstein & Hassett, *supra* note 1, at 17. *See* DePillis, *supra* note 111 ("I'm here to tell you [the Opportunity Act] is the biggest program that anyone has ever seen in their lifetime.") (quoting Emanuel Friedman, Chief Exec. Off. & Co-Chief Inv. Off., EJF Capital LLC).

188. *E.g.*, Unlike the NMTC program, QOFs need not obtain approval or certification by the CDFI Fund before receiving the Act's tax benefits; *see also* DePillis, *supra* note 111 (discussing how Congress "intentionally crafted [the Opportunity Act] to be free of the many rules and restrictions that have guided similar programs in the past.").

America's communities most in need. First, the Eligible Tracts list should be narrowed to focus on the poorest American communities and to limit gamesmanship in the Nomination Process. Second, local leaders should be involved in the investment process to oversee the impact of the QOFs within the community and to minimize how often QOF investments harm (or ineffectively serve) communities in which they invest; and third, the Opportunity Act should be modified to encourage investments into non-real estate projects.

A. *Target True LICs*

As mentioned previously, fifty-seven percent of American localities qualify as an Eligible Tract—which is hardly limiting.[189] To ensure investments are indeed ending up in the poorest American localities, the Eligible Tract criteria should be narrowed.

LICs are currently defined as tracts that either had (i) a poverty rate of at least twenty percent or (ii) a median household income equal to or less than eighty percent of the statewide median household income (or the metropolitan area median household income, if the tract was located in a metropolitan area).[190] To target true LICs, the poverty rate and comparative median household income requirements should be modified.[191]

By increasing the poverty rate and decreasing the comparative percentage of median household income required to be an LIC, the Opportunity Act could better target the nation's localities most in need.[192] Additionally, to further limit the eligibility requirements of Eligible Tracts, State CEOs could be further required to focus investments on the poorest localities and to avoid using the Nomination Process to achieve state-specific, political motives.[193]

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189. *See supra* Part I.B.1.

190. Congress incorporated the NMTC's definition of an LIC into the Opportunity Act. I.R.C. § 45D(e).

191. Congress's most recent proposal calls for such changes to the Opportunity Act, instituting "replacement zones" for "disqualified census tracts," which include those with a census median household income that exceeds 130% of the national median family income unless the poverty rate in such tracts equals at least thirty percent. H.R. 7467, 117th Cong. § 101(g) (2022).

192. This could also include a cost-of-living analysis to create a more accurate sense of poverty within each state.

193. By limiting the eligibility requirements for LICs, some states may have less than twenty-five communities that qualify for investment. To ensure that investment remains in the poorest communities nationally, the twenty-five-community quota should be eliminated. If a state only has ten communities that experience extreme poverty, the state should direct all investments to those communities rather than selecting an additional middle-class community to further improve. Or maybe each state

Limiting Eligible Tracts to the poorest localities would likely decrease investments through the Act, but the investments that are made would truly be directed at improving America's neediest communities.

Although investments in less impoverished Eligible Tracts may be more impactful than those in poorer communities,[194] the Act does not take that stance. As the Act was presented and is currently written, the investments appear to have the poorest communities in mind, not middle-class communities.[195]

B. Transparency Through Local Oversight

Local governments of distressed communities should be more involved in improving their constituents' lives. However, they should not be asked or expected to decide between further expending their already minimal funds to remedy a failing federal government program, and watching such government program displace their citizens. That kind of proposal retroactively expects local governments to solve a problem created by the federal government and then to suffer the fiscal consequences of doing so.

Instead, the federal government should preempt inefficient subsidies by enlisting the help of state and local governments. Congress should amend the Opportunity Act to require QOFs to coordinate QOZ Projects with local government leaders, and with state government leaders when the former are unavailable.[196] To preserve some flexibility, QOFs and local government would not be required to brainstorm QOZ Projects together, and local government would not even be required to create a list of QOZ Projects; QOFs would simply

must have at least five localities in the bottom ten percent of America's localities for every one locality above that ten percent threshold.

194. Some could argue that middle-class communities already have the necessary foundation to effectuate lasting change, while the poorest localities would simply return to their poverty as soon as the investments are removed due to a lack of infrastructure.

195. With that said, many middle-class communities receive investment through the nomination quota, through two tier investment structures, and by other means.

196. The constitutionality of mandating state and local government involvement as discussed herein will not be analyzed in this Note. However, we rest the constitutionality of this proposal on the spending power, since tax expenditures like those offered by the Opportunity Act are an indirect form of spending. *See* South Dakota v. Dole, 483 U.S. 203 (1987). Under *Dole*'s four-part test, the Opportunity Act is clearly for the general welfare of the United States; requiring investors to obtain local governments' approval of QOZ Projects in coordination with QOFs is a clear and unambiguous condition; requiring investors to obtain local government approval is related to the purpose of the Act's tax incentives as well as their effects; and requiring investors to obtain local government approval is not barred by other constitutional provisions.

need to obtain local government approval before claiming the Opportunity Act's tax incentives.

Implementation could be administratively simple, as QOFs would be required to do only three things after securing local government approval: (i) check a box on a Form 8996 to indicate that they obtained local government approval; (ii) authorize their investors to check the appropriate box on a Form 8997 indicating that their QOF obtained local government approval; and (iii) substantiate such approval by providing minimal documentation including the parties' names, the investment amount, and the QOZ Project.

Although this proposal may be viewed as placing another burden on the shoulders of local leaders, requiring QOFs to collaborate with local leaders may not be too troublesome.[197] In addition, this local government emphasis could ameliorate the issues of equity, efficiency, and administrability elaborated above. Local governments of impoverished communities could aim to ensure that participating investors receive federal subsidies in exchange for delivering socio-economic benefits to the communities in which they invest.[198]

Although the Act would remain inefficient in that it influences investment into higher risk-lower return ventures, local governments could seek to ensure that investments benefit low-income residents while being held democratically accountable by their constituents.

Lastly, sending multiple forms of QOF investment data—one from the QOF itself and the other from the local government whose approval has been obtained—would allow the IRS to process QOF information in an effective manner.[199] Moreover, local or state leaders involved in QOF investments may decide to measure the investments' social impact and consequently relieve the IRS from having to collect such data.

Like every other proposal, this one is imperfect. This proposal introduces additional administrative tasks for QOFs. Not only will it deter participation by increasing transactional costs, but this proposal may also diminish investors' prospects for obtaining attractive profits,

197. At least one QOF has described its negotiations with local leaders as "pretty seamless." U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 20.

198. Economically distressed residents are more likely to hold local government leaders accountable, theoretically through the democratic process, than they are to hold wealthy investors accountable.

199. According to the GAO report issued late in 2021, the IRS is considering "automated matching of information reported by investors and funds with information from third parties and other sources." U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-104019, at 38.; *see also id.* at 38 n.46 ("As of June 2021 . . . [the] IRS has taken steps to operationalize the plan.").

since many, if not most, lucrative QOZ Projects exacerbate low-income community needs.[200] However, local governments may respond to these concerns by easing QOFs' administrative challenges elsewhere, such as facilitating permit-acquisition or prioritizing QOZ Projects on city ballots. This way, local governments could re-incentivize QOZ Projects by using other than fiscal means.

C. Tax Breaks for Non-Real Estate Projects

The final proposal involves increasing the breadth of the Opportunity Act to give additional tax incentives or to modify existing incentives for QOFs that invest in projects other than real estate.

As noted by recent scholarship, QOZ Projects have been disproportionately focused on real estate investment and development.[201] Yet these real estate projects often lead to increased rents that may end up hurting residents of economically distressed communities.

To limit the negative externalities of real estate development, the Opportunity Act could be modified to further incentivize investment into small businesses, local initiatives, and other community-focused opportunities. This could be done by accelerating the tax incentive timeline or by adding additional tax incentives for non-real estate investments.

Investors would be more incentivized to invest in non-real estate projects if the tax benefits were to be accelerated for these projects. This may be done by pulling the investments back three years from where they are currently placed. In other words, the investors could receive the ten percent step-up in basis after two years (rather than the current Act's five-year timeline), the five percent step-up after four years (rather than seven years), and the exclusion of gains after seven years (rather than ten years).[202]

If an accelerated timeline is not feasible, the Act could instead add a unique tax benefit for non-real estate projects, such as an increased window to invest gains into a QOZ Project or increased flexibility to jump from one project to another.

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200. For example, real estate investments often displace already rent-burdened residents. *See supra* Part II.B.2.b.

201. Eldar & Garber, *supra* note 154.

202. Real estate investment is often a long-term play, whereas small businesses and community initiatives may be much shorter lived. Decreasing the years needed for a step up in basis may not only incentivize investment in these non-real estate projects, but it may also better reflect the nature of these shorter and more volatile investment opportunities.

Each of these proposed solutions would improve the Opportunity Act's application. By focusing investments on true LICs, working with local leaders to ensure impact, and investing in projects other than real estate, the Opportunity Act could better serve the economically distressed localities of America.

Conclusion

During a time of gross economic inequality, Congress enacted the Investing in Opportunity Act: a hopeful improvement on previous place-based policies. The Act's tax incentives are powerful and sought to draw an unprecedented amount of investment into America's poorest communities. The Opportunity Act indeed has attracted significant investment into state-designated areas, although not quite to the levels it had anticipated. More fatally, however, is that in empowering the Opportunity Act, Congress also unhinged it, leaving significant opportunity for private gamesmanship. Though politically appealing and economically attractive, the Opportunity Act's application has been inequitable, inefficient, and administratively demanding.

This Note suggests that the Opportunity Act could be greatly improved if investments were limited to America's neediest communities, QOFs were required to enlist the help of local and state governments, and the Act incentivized investment into non-real estate projects. The Investing in Opportunity Act has a lot of potential. With a few reforms, this Act could effectuate its original purpose—revitalize America's poorest communities.