OPPORTUNITY ZONES: A PROGRAM IN SEARCH OF A PURPOSE

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ABSTRACT

In 2017, Congress created the Opportunity Zone ("OZ") program to stimulate economic growth in low-income communities. The program was characterized by its unprecedented scale relative to previous place-based development efforts and was described as "perhaps the most ambitious economic development tool to come out of Congress in a generation." However, the program was quickly criticized on numerous grounds, and its design flaws are so severe that several legislators have called for its reform or repeal.

This Essay argues that the root of the OZ program's problems is a strong mismatch between its stated purpose and its actual terms. We discuss how the OZ program works and why the actual terms of its enabling legislation encourage investors to focus on real estate projects. We show that, contrary to common perceptions of the OZ program, its intended purpose was to promote entrepreneurship and startup activity. We conduct an empirical analysis to show that low-income tracts did not experience any increase in startup investment following OZ designation. Overall, our results suggest that OZ designation has generally failed to achieve its stated goal and that the serious concerns about its manipulability to favor specific investors are warranted. Finally, we consider various proposals to make the OZ program more consistent with its original goal and briefly note how the legislative process behind the OZ statute may have contributed to its shortcomings.

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We would like to thank Stuart Benjamin, Edward De Barbieri, Sarah Bloom Raskin, Rory Van Loo, Jonathan Wiener, and Lawrence Zelenak for their helpful feedback on this Essay. We would also like to thank the participants at the *Boston University Law Review* Symposium on Law, Markets, and Distribution as well as the students in the Boston University School of Law Spring 2022 Financial Regulation course for their insightful questions. Finally, we would like to thank the editors at the *Boston University Law Review* for excellent editing and thoughtful comments to improve the piece.

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INTRODUCTION

In the Tax Cuts and Jobs Act of 2017, Congress created the Opportunity Zone ("OZ") program,[1] which is "perhaps the most ambitious economic development tool to come out of Congress in a generation."[2] The gist of the program is that it provides investors with various capital gains tax breaks if they invest in designated OZs.[3] These zones, which each state's governor selected from among all low-income tracts across the United States,[4] cover an unprecedented 7,826 census tracts in all fifty states and Washington, D.C.[5] Prior place-based development efforts were much narrower. For example, the Clinton-era Empowerment Zone ("EZ") program[6] targeted only 234 tracts in six cities in its first round,[7] and the more recent New Markets Tax Credit ("NMTC") program[8] reached just 3,654 tracts between 2001 and 2017.[9] The broad scope of the OZ program was designed to draw vast amounts of capital to low-income

[1] Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13823, 131 Stat. 2054, 2183-88 (codified as amended at I.R.C. §§ 1400Z-1 to -2).

[2] Press Release, Cory Booker, Sen., U.S. Senate, Booker, Scott, Hassan, Young Introduce Bipartisan Bill to Strengthen Reporting Requirements for Opportunity Zone Tax Incentive (May 8, 2019), https://www.booker.senate.gov/news/press/booker-scott-hassan-young-introduce-bipartisan-bill-to-strengthen-reporting-requirements-for-opportunity-zone-tax-incentive [https://perma.cc/QY98-SWSJ].

[3] *See, e.g.*, I.R.C. § 1400Z-2(a)(1) (providing for preferable treatment of capital gains income invested in qualified opportunity funds); *see also infra* Part I (providing overview of OZ program's structure and tax benefits).

[4] I.R.C. § 1400Z-1(b)(1)(A).

[5] *See Opportunity Zones by Location*, OPPORTUNITYDB, https://opportunitydb.com/location/ [https://perma.cc/8E9T-B493] (last visited Apr. 18, 2022) (identifying 8,764 OZs, including 938 in U.S. territories). A census tract is a small statistical subdivision of a county with a population size that is generally between 1,200 and 8,000 people. *Glossary*, U.S. CENSUS BUREAU, https://www.census.gov/programs-surveys/geography/about/glossary.html [https://perma.cc/QX9E-QTUU] (last updated Apr. 11, 2022).

[6] I.R.C. §§ 1396-1397D (establishing tax incentives for businesses operating within EZs).

[7] Matias Busso, Jesse Gregory & Patrick Kline, *Assessing the Incidence and Efficiency of a Prominent Place Based Policy*, 103 AM. ECON. REV. 897, 913 (2013).

[8] I.R.C. § 45D (establishing tax incentives for investments in qualified community development entities).

[9] BRETT THEODOS, CHRISTINA PLERHOPLES STACY, DANIEL TELES, CHRISTOPHER DAVIS & ANANYA HARIHARAN, URB. INST., WHERE DO NEW MARKETS TAX CREDIT PROJECTS GO?: EVALUATING THE NMTC PROGRAM 5 (2021), https://www.urban.org/sites/default/files/publication/103995/where-do-new-markets-tax-credit-projects-go_0.pdf [https://perma.cc/65XP-4FPF].

communities across the United States.[10] In this way, the program sought to address the deficiencies of similar programs that arguably have limited reach.[11]

Unfortunately, it was not long before the OZ program attracted a barrage of criticism,[12] and commentators have raised serious concerns that it has so far had limited impact.[13] The program has been criticized on various grounds, including

[10] *See* Jim Tankersley, *A Potential Win for Distressed America*, N.Y. TIMES, Jan. 30, 2018, at B1 (describing how OZs "will use tax incentives to draw long-term investment to parts of America that continue to struggle with high poverty and sluggish job and business growth"); Stephanie Dhue & Ylan Mui, *Investors Can Get Big Tax Breaks if They Invest in 'Opportunity Zones' Under New Treasury Rules*, CNBC (Oct. 19, 2018, 3:18 PM), https://www.cnbc.com/2018/10/19/investors-can-get-tax-breaks-for-investing-in-opportunity-zones-treasury.html [https://perma.cc/9UN2-EXE9] ("Treasury Secretary Steven Mnuchin estimated as much as $100 billion in private capital could be funneled into those areas [designated as OZs].").

[11] *See* Tankersley, *supra* note 10, at B4 (describing prior federal place-based efforts as "largely ineffective" and "relatively limited in scope"); JARED BERNSTEIN & KEVIN A. HASSETT, ECON. INNOVATION GRP., UNLOCKING PRIVATE CAPITAL TO FACILITATE ECONOMIC GROWTH IN DISTRESSED AREAS 14 (2015), https://eig.org/wp-content/uploads/2015/04/Unlocking-Private-Capital-to-Facilitate-Growth.pdf [https://perma.cc/VYB8-VZE6] (criticizing restrictive scope of previous programs and noting that "restrictions on the size of investment that can qualify discourages large well-capitalized investors from participating").

[12] *See, e.g.*, David Yaffe-Bellany, *The Trump Associates Benefiting from a Tax Break for Poor Communities*, N.Y. TIMES (Aug. 31, 2019), https://www.nytimes.com/2019/08/31/business/the-trump-associates-benefiting-from-a-tax-break-for-poor-communities.html (criticizing OZ program for funneling money to high-profile investors and their luxury projects); Tony Mecia, Opinion, *Opportunity Zones Knock Where They're Needed Least*, WALL ST. J., Sept. 14-15, 2019, at A13 (criticizing classification of some census tracts as high poverty for OZ purposes when concentrated presence of college students skewed median income); Jeff Ernsthausen & Justin Elliott, *One Trump Tax Cut Was Meant to Help the Poor. A Billionaire Ended Up Winning Big.*, PROPUBLICA (June 19, 2019, 4:00 AM), https://www.propublica.org/article/trump-inc-podcast-one-trump-tax-cut-meant-to-help-the-poor-a-billionaire-ended-up-winning-big [https://perma.cc/LVZ3-BZYC] (criticizing OZ program for windfall to luxury waterfront project in Baltimore); Jeff Ernsthausen & Justin Elliot, *How a Tax Break to Help the Poor Went to NBA Owner Dan Gilbert*, PROPUBLICA (Oct. 24, 2019, 2:10 PM), https://www.propublica.org/article/how-a-tax-break-to-help-the-poor-went-to-nba-owner-dan-gilbert [https://perma.cc/2MMP-CMSM]; Lydia DePillis, *A 'Mind Boggling' Tax Break Was Meant to Help the Poor. But Trendy Areas Are Winning Too*, CNN BUS. (June 14, 2019, 8:32 AM), https://www.cnn.com/2019/06/14/economy/opportunity-zones-investing-los-angeles/index.html [https://perma.cc/NM4A-MBWN] (criticizing designation of trendy neighborhoods in Los Angeles as OZs); Alex Nitkin, *How a $2B Redevelopment Site in Chicago Landed in a Federal Opportunity Zone: A TRD Investigation*, THEREALDEAL (May 1, 2019, 4:56 PM), https://therealdeal.com/chicago/2019/05/01/how-a-2b-redevelopment-site-in-chicago-landed-in-an-opportunity-zone-a-trd-investigation/ [https://perma.cc/B64F-35U2] (criticizing designation of two tracts in Chicago as OZs when city had previously begun "megaproject" that would subsequently benefit); Noah Buhayar, *Tax Breaklandia*, BLOOMBERG BUSINESSWEEK, Jan. 21, 2019, at 30, 30-31 (criticizing designation of downtown Portland, Oregon, as OZ even though it contains luxury neighborhoods).

[13] *See, e.g.*, Sophie Quinton, *Opportunity Zones Don't Boost Economic Activity, Research Says*, PEW: STATELINE (Feb. 25, 2021), https://www.pewtrusts.org/en/research-and-

potential favoritism in the selection of nonmeritorious tracts by governors;[14] lack of transparency with respect to the projects and investors that claim the tax benefits;[15] insufficient OZ investment, which was directed almost exclusively toward a small number of tracts;[16] and failure of projects that received tax benefits to assist low-income people.[17] While it is too early to conclude that the OZ program is ineffectual, its design flaws are so severe that it is hard to be optimistic about its future.[18] In fact, there have been a series of proposals to reform the OZ program as well as proposals to eliminate it altogether.[19]

This Essay argues that the root of the OZ program's problems is a strong mismatch between its stated purpose and its actual terms. Contrary to common

analysis/blogs/stateline/2021/02/25/opportunity-zones-dont-boost-economic-activity-research-says [https://perma.cc/V8KX-K74T] (summarizing researchers' findings that suggest "[t]he opportunity zone tax break so far appears to be having little to no impact on economic activity in distressed communities"); BRETT THEODOS, ERIC HANGEN, JORGE GONZÁLEZ & BRADY MEIXELL, URB. INST., AN EARLY ASSESSMENT OF OPPORTUNITY ZONES FOR EQUITABLE DEVELOPMENT PROJECTS: NINE OBSERVATIONS ON THE USE OF THE INCENTIVE TO DATE 4-5 (2020), https://www.urban.org/sites/default/files/publication/102348/early-assessment-of-ozs-for-equitable-development-projects_0.pdf [https://perma.cc/3F6D-WQVR] (concluding that OZ incentives "need to be redesigned so government dollars are allocated effectively and help project sponsors achieve [intended equitable development] outcomes").

14 *See, e.g.*, Ofer Eldar & Chelsea Garber, *Does Government Play Favorites?: Evidence from Opportunity Zones* 3 (Duke L. Sch. Pub. L. & Legal Theory Series No. 2020-28, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3463541 [https://perma.cc/48QU-EMLL] (finding that "tracts in counties with strong support for the governor in the last election were about 5 percent more likely to be selected [as OZs]" and that "[gubernatorial] campaign contributions by investors are associated with a 6.4-13.3 percent greater probability of OZ designation").

15 *See, e.g.*, Edward W. De Barbieri, *Opportunism Zones*, 39 YALE L. & POL'Y REV. 82, 148 (2020) ("There are two key problems with respect to transparency as it applies to improving the Opportunism Zone. First, the tool lacks a periodic reporting requirement. Second, the process for zone designation in the states and territories is opaque . . . .").

16 *See, e.g.*, Patrick Kennedy & Harrison Wheeler, Neighborhood-Level Investment from the U.S. Opportunity Zone Program: Early Evidence 10-11 (Apr. 13, 2022) (unpublished manuscript) (available at https://www.dropbox.com/s/mh891vmlt2ynp8p/oz_kennedy_wheeler_13apr2022.pdf [https://perma.cc/XS7X-LLMV]) ("Overall, the distribution of investment across all OZ tracts is highly skewed, such that the top 5% of tracts receive 78% of total investment, and the top 1% of tracts receive 42% of total investment.").

17 *See* sources cited *supra* note 12 (highlighting examples of OZ benefits accruing to wealthy investors, developers, and communities).

18 *See* De Barbieri, *supra* note 15, at 155 ("[T]he Opportunity Zone is a radical, dangerous economic development tool that exemplifies the worst tendencies of the trend toward market-based solutions to societal problems."); Daniel Hemel, *A Place for Place in Federal Tax Law*, 45 OHIO N.U. L. REV. 525, 531 (2019) ("The opportunity zone provision effectively incorporates the worst elements of earlier spatially differentiated tax incentives while leaving out the redeeming qualities. . . . [I]t manages both to be complicated and poorly targeted at the same time.").

19 *See infra* notes 199-223 and accompanying text (discussing legislative proposals to reform or eliminate OZ program).

perceptions of the OZ program, we show that its intended purpose was promoting entrepreneurship and startup activity.[20] In fact, the program was initiated by Sean Parker, the startup entrepreneur, who envisaged a venture capital ("VC")-like structure for pooling investment funds in designated distressed communities.[21] The theory was that startup activity would generate growth and development in low-income communities, thereby creating jobs, increasing consumption, and raising property values. As discussed below, the mission of promoting startup activity is also reflected in the legislative history of the Act that created the program, including in an early version of the bill.[22]

Contrary to this stated purpose, the actual terms of the legislation hardly do enough to further it. As we explain below, the OZ program appears to primarily encourage investors with a great deal of unrealized capital gains to reinvest these gains in real estate projects in designated areas.[23] In fact, much of the anecdotal evidence concerning investments in OZs focuses on real estate projects, specifically those that do not appear to be directed at helping low-income groups. To take one of many examples, OZ tax benefits helped "finance the construction of a 46-story, glass-wrapped apartment tower — amenities include a yoga lawn and a pool surrounded by cabanas and daybeds — in a Houston neighborhood already brimming with new projects aimed at the wealthy"[24] and where the median family income was $250,000 in 2017.[25] The only benefit to the residents of designated tracts appears to be the wishful hope that these real estate projects will somehow spur economic activity that will trickle down to the local community. The concern is thus that a latent motivation for the program, or at least the motivation for the politicians who supported it, was to benefit wealthy real estate investors rather than low-income communities.[26] In fact, the program is now associated so strongly with real estate that, somewhat

[20] *See infra* Part II (detailing history of OZ program's creation).

[21] Steven Bertoni, *An Unlikely Group of Billionaires and Politicians Has Created the Most Unbelievable Tax Break Ever*, FORBES (July 18, 2018, 6:00 AM), https://www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-created-the-most-unbelievable-tax-break-ever/.

[22] *See* Tax Cuts and Jobs Act, S. 1, 115th Cong. § 13823 (as reported by S. Comm. on the Budget, Nov. 28, 2017) (guiding governors to select zones that were already "the focus of . . . economic development initiatives to attract investment and foster startup activity").

[23] *See infra* Part I (explaining how and why OZ program favors real estate development).

[24] Jesse Drucker & Eric Lipton, *Meant to Lift Poor Areas, Tax Break Is Boon to Rich*, N.Y. TIMES, Sept. 1, 2019, Late Edition, at 1.

[25] *See* Eldar & Garber, *supra* note 14, app. at B5.

[26] *See id.* at 26 ("[T]here is robust evidence that governors exercised their discretion to reward political supporters and investors that contributed to their campaigns."); Hemel, *supra* note 18, at 526 ("The legislation is so poorly designed that one wonders whether the flaws might have been intentional: whether this was simply a cynical attempt to give tax breaks to rich donors . . . .").

shockingly, hardly anyone is aware of its apparent purpose of promoting startup activity.[27]

To evaluate whether the OZ program may nonetheless be a tool for spurring VC-like investments, we conduct a preliminary evaluation of the program to determine whether we observe any change in VC investments in low-income tracts following their designation as OZs.[28] We find no such evidence, which further supports the idea that the program does relatively little to promote startup activity in designated tracts. The only exception to this finding is a temporary increase in VC investments in OZ tracts that may have been designated as OZs partly to benefit investors affiliated with the designating governors. Drawing on our other work that finds that political favoritism may have played a role in the OZ selection process,[29] we thus find that OZs associated with favoritism toward investors may have benefited from a one-time infusion of VC investment following their designation relative to OZs that were not associated with favoritism. Overall, these preliminary results suggest that OZ designation has generally failed to achieve its stated goal and that the serious concerns about its manipulability to favor specific investors are warranted.

This Essay proceeds as follows. In Part I, we discuss how the OZ program works and why its provisions are particularly favorable to real estate investors. In Part II, we describe the history of the OZ program's creation and the discussions of its purpose during the legislative process. In Part III, we conduct an empirical analysis of the impact of OZ designation on VC investment, showing that the program has had no effect on VC investment in designated tracts. In Part IV, we consider various reform proposals to make the OZ program more consistent with its original goal of promoting entrepreneurship. In Part V, we briefly note how the legislative process behind the OZ statute may have contributed to its shortcomings.

I. HOW OZS FAVOR REAL ESTATE INVESTORS

Congress initially created the OZ program with just six pages of text tucked into the 185-page Tax Cuts and Jobs Act of 2017.[30] In this Part, we first review the basic structure of the statute. Then, drawing on specific provisions in both the statute and the subsequent Treasury regulations, we show that the provisions of the OZ program favor real estate investors over startup investors.

[27] *See* David Zipper, *How Opportunity Zones Launched a 'Gold Rush' for Wealthy Investors*, BLOOMBERG: CITYLAB (Nov. 11, 2021, 8:00 AM), https://www.bloomberg.com/news/articles/2021-11-11/why-opportunity-zones-failed-to-help-low-income-areas ("It seems like Opportunity Zones were touted as an economic development and business growth program, but ended up being a real estate finance program.").

[28] *See infra* Part III (analyzing OZ program's impact on VC investment).

[29] *See* Eldar & Garber, *supra* note 14, at 26.

[30] Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13823, 131 Stat. 2054, 2183-88 (codified as amended at I.R.C. §§ 1400Z-1 to -2); Drucker & Lipton, *supra* note 24, at 18.

A. *The Basic Statutory Framework of the OZ Program*

This Section briefly reviews the two key statutory provisions that launched the OZ program. The first provision addresses the OZ designation process.[31] The statute authorizes the governor of each state to nominate census tracts for designation as OZs.[32] These OZ designations remain in effect for ten years.[33] To be eligible for selection, the tract must either qualify as a low-income community[34] or be contiguous with a designated OZ.[35] Governors may designate up to 25% of the number of low-income communities in their state as OZs.[36] There is no detailed review process for the governors' selections, which is particularly striking because the benefits are provided by the federal government.[37]

The second provision defines three tax benefits for investing in designated OZs.[38] First, a taxpayer who invests unrealized capital gains income in a qualified opportunity fund ("QOF") can defer paying taxes on that gain until the sale of the OZ investment or until the end of 2026, whichever is earlier.[39] Second, if the investment is held in the QOF for five years, the taxable amount of the original deferred gain is reduced by 10%; if the investment is held for seven years, the taxable gain is reduced by 15%.[40] Third, if the investment is held for at least ten years, the tax on any additional capital gains realized through the OZ investment is entirely eliminated.[41] The third incentive is arguably the

[31] I.R.C. § 1400Z-1.

[32] *Id.* § 1400Z-1(b)(1)(A).

[33] *Id.* § 1400Z-1(f). Because designations were announced in 2018, current zones are set to expire at the end of 2028.

[34] *Id.* § 1400Z-1(a). A tract generally qualifies as a low-income community if the poverty rate is at least 20% or the median family income does not exceed 80% of the statewide or metropolitan area median family income. *See id.* § 45D(e)(1) (defining "low-income community" for NMTC purposes); *id.* § 1400Z-1(c)(1) (providing that "low-income community" in OZ program will have same meaning as in NMTC program).

[35] *Id.* § 1400Z-1(e)(1). The median family income in these tracts cannot exceed 125% of the median family income in the adjacent low-income community. *Id.* Census tracts designated under the contiguous criteria are capped at 5% of OZs in each state. *Id.* § 1400Z-1(e)(2).

[36] *Id.* § 1400Z-1(d)(1). If a state has fewer than 100 low-income communities, however, its governor may designate up to twenty-five as OZs. *Id.* § 1400Z-1(d)(2).

[37] *See id.* § 1400Z-1(b)(1)(B) (describing rubber-stamp approval process whereby "the [Treasury] Secretary certifies such nomination [by the governor] and designates such tract as a qualified opportunity zone").

[38] *Id.* § 1400Z-2.

[39] *Id.* § 1400Z-2(b)(1).

[40] *See id.* § 1400Z-2(b)(2)(B) (describing tax basis increase for each relevant holding period).

[41] *Id.* § 1400Z-2(c) (setting basis of property to its fair market value at time of sale). President Trump seemingly touted this substantial tax break by saying he "lowered the capital gains tax for long-term investment in Opportunity Zones all the way down to a very big, fat,

most substantial and results in a tax benefit that is directly proportional to the return on investment. Indeed, according to Treasury, "[t]he incentive provided by [the elimination of post-acquisition capital gains if held for ten years] is integral to the primary purpose of the provision."[42]

The second provision also provides some details on the basic structure of qualifying investments. The Act defines a QOF as "any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property."[43] The only statutory requirement is that a QOF must hold at least 90% of its assets in "qualified opportunity zone property."[44] Investments eligible for the OZ program's tax benefits include the acquisition or substantial improvement of tangible property used in the business of the QOF[45] and the acquisition of stock or a partnership interest in an "opportunity zone business."[46] To qualify as an OZ business, an entity must hold "substantially all" of its tangible property as qualified OZ business property;[47] must derive at least 50% of its gross income from, and use a "substantial portion" of its intangible property in, its active conduct in the OZ; and the aggregate unadjusted bases of the entity's property must be almost entirely attributable to qualified financial property.[48] A few types of businesses are categorically barred from qualifying as OZ businesses.[49]

Beyond the basic structure of the program, the statute itself is intentionally light on the details; the two provisions together contain approximately 2,500 total words in the Internal Revenue Code.[50] Instead, the statute leaves a number of regulatory details to the Treasury Secretary, including "rules for the certification of qualified opportunity funds" and "rules to prevent abuse."[51] Indeed, investors faced substantial uncertainty in the months following OZ designations, with a number of crucial questions about qualifying investments

beautiful number of zero. Zero." Remarks at an Opportunity Zones Conference with State, Local, Tribal, and Community Leaders, 2019 DAILY COMP. PRES. DOC. 2 (Apr. 17, 2019).

42 Prop. Treas. Reg. (Explanation of Provisions), 83 Fed. Reg. 54279, 54283 (Oct. 29, 2018).

43 I.R.C. § 1400Z-2(d)(1).

44 *Id.*

45 *Id.* § 1400Z-2(d)(2)(D). The statute explains that a property is substantially improved by the QOF if "during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period." *Id.*

46 *Id.* § 1400Z-2(d)(2)(B) to (C).

47 *Id.* § 1400Z-2(d)(3).

48 *Id.* § 1397C(b)(2), (4), (8); *see id.* § 1400Z-2(d)(3)(A)(ii).

49 The short list includes "any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises." *Id.* § 144(c)(6)(B); *see id.* § 1400Z-2(d)(3)(A)(iii).

50 *See id.* §§ 1400Z-1 to -2.

51 *Id.* § 1400Z-2(e)(4).

left unanswered.[52] Treasury repeatedly acknowledged that the lack of regulatory clarity caused hesitancy among potential OZ investors in the early months.[53]

B. *The OZ Provisions Are Favorable to Real Estate Investors*

There are several reasons OZ investors favor real estate projects. This Section details the incentive structure that tilts the OZ project mix toward real estate. First and foremost, OZ investors favor real estate because it is simpler to maintain compliance with the statutory requirements for such projects. As discussed above, qualified OZ businesses must hold substantially all tangible property as qualified OZ business property.[54] In turn, tangible property may only be qualified OZ business property if substantially all of its use is in an OZ.[55] The rules clarify that a business will satisfy the substantially all requirement at the 70% threshold.[56] For real estate projects, determining compliance is as easy as determining whether the property is in a designated tract. Additionally, because real estate cannot move, real estate projects will not lose their qualified OZ business property status over the ten-year time horizon that investors seek to maximize their tax benefits.[57]

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[52] *See* Amanda H. Nussbaum, David S. Miller, Jean Bertrand & Sean Webb, *Final Regulations on Opportunity Zones*, PROSKAUER: TAX BLOG (Jan. 22, 2020), https://www.proskauertaxtalks.com/2020/01/final-regulations-on-opportunity-zones/ [https://perma.cc/Y5MQ-8QH4] ("The opportunity zone statute left many uncertainties regarding the fundamental operations of the opportunity zone program."); Christopher Hanewald, *Qualified Opportunity Zones: Delayed Timelines and Tracking Changes*, BLOOMBERG TAX (Mar. 12, 2021, 4:00 AM), https://news.bloombergtax.com/daily-tax-report/qualified-opportunity-zones-delayed-timelines-and-tracking-changes [https://perma.cc/NL6U-QNEX] ("Following creation of the qualified opportunity zone (QOZ) program in the Tax Cuts and Jobs Act, interested parties waited nearly two years before regulations were finalized by the Treasury and the IRS." (citations omitted)).

[53] *See* Prop. Treas. Reg. (Regul. Plan. & Rev.), 84 Fed. Reg. 18652, 18670 (May 1, 2019) ("The Treasury Department and the IRS are aware of concerns raised by commenters that investors have been reticent to make substantial investments in QOFs without first having additional clarity on which investments in a QOF would qualify to receive the preferential tax treatment specified by the [Tax Cuts and Jobs Act]."); Prop. Treas. Reg. (Regul. Plan. & Rev.), 83 Fed. Reg. 54279, 54287 (Oct. 29, 2018) ("[T]he reduction in uncertainty [provided by the proposed regulations] should encourage investment to flow into qualified opportunity zones, consistent with the intent of the [Tax Cuts and Jobs Act].").

[54] I.R.C. § 1400Z-2(d)(3)(A)(i).

[55] *Id.* § 1400Z-2(d)(2)(D)(i)(III); *see id.* § 1400Z-2(d)(3)(A)(i).

[56] Treas. Reg. § 1.1400Z2(d)-2(d)(4) (as amended in 2021).

[57] *See* Lauren Lambie-Hanson, *Addressing the Prevalence of Real Estate Investments in the New Markets Tax Credit Program* 28 (Fed. Rsrv. Bank of S.F., Working Paper No. 2008-04, 2008), https://www.frbsf.org/community-development/publications/working-papers/2008/september/new-markets-tax-credit-real-estate-investments/ [https://perma.cc/RP3A-RCS9] (describing similar phenomenon for NMTC because "real estate projects will not lose their [qualified] status and thus pose less risk of recapture").

Second, the Treasury guidance since the OZ program's creation has been more responsive to real estate projects as compared to startup investment.[58] Indeed, "the initial rounds of Treasury regulations focused on defining the rules for real estate investments, leaving lots of questions about investing in start-ups and other businesses hanging."[59] Apparently, "favoring real estate was intentional because some at the Treasury didn't think directing money toward risky start-up businesses was wise."[60] This could explain the tilt toward real estate in the early months as investors faced uncertainty about qualifying businesses investments. But even as the final regulations answered lingering questions about qualifying OZ businesses, they also included several rules that were even more favorable to real estate investments.[61]

There are several examples of these real estate-friendly provisions. At least two provisions create exemptions from the statutory "substantial improvement" requirement that facilitate real estate projects. For example, under the statute, qualified OZ business property does not need to be substantially improved if "the original use of such property in the qualified opportunity zone commence[d] with the qualified opportunity fund."[62] The early guidance proposed that a building that had been vacant for five years would satisfy the "original use" requirement.[63] However, the final regulations relax this requirement to three years and even include a special one-year vacancy requirement for property that was vacant beginning at least a year prior to when OZ designations were made.[64] Similarly, the final regulations provide that an entity may treat "all real property composing [a purchased] brownfield site (including land and structures thereon) as satisfying the original use requirement" if the entity makes health and safety investments in the site.[65] These regulations are explicitly designed to encourage real estate projects on vacant land and brownfield sites.

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[58] *See* Hanewald, *supra* note 52 (noting that "the barebones legislation and first round of proposed regulations strongly favored the real estate industry"); DAVID WESSEL, ONLY THE RICH CAN PLAY: HOW WASHINGTON WORKS IN THE NEW GILDED AGE 140 (2021).

[59] WESSEL, *supra* note 58, at 140.

[60] *Id.*

[61] Jim Tankersley, *Treasury Dept. Finishes Opportunity Zone Rules*, N.Y. TIMES, Dec. 21, 2019, at B3 ("The regulations make it easier for certain real estate projects to qualify for tax advantages . . . .").

[62] I.R.C. § 1400Z-2(d)(2)(D)(i)(II).

[63] Prop. Treas. Reg. (Explanation of Provisions), 84 Fed. Reg. 18652, 18654 (May 1, 2019) (codified at Treas. Reg. § 1.1400Z2(d)-2(b)(3)(i)(B) (as amended in 2021)).

[64] *See* Treas. Reg. § 1.1400Z2(d)-2(b)(3)(i)(B). During the regulatory comment period, several real estate interest groups pushed for this rule to be relaxed. *See, e.g.*, Nat'l Multifamily Hous. Council & Nat'l Apartment Ass'n, Comment Letter on Proposed Rule on Investing in Qualified Opportunity Funds 2 (Dec. 7, 2018), https://www.regulations.gov /comment/IRS-2018-0029-0027 [https://perma.cc/D4F5-RY7E].

[65] Treas. Reg. § 1.1400Z2(d)-2(b)(3)(iv).

Additionally, multiple provisions make it easier to meet the substantial improvement requirement when it does apply. For example, the rules state that in the case of a building located in an OZ, the basis of the land is excluded from the substantial improvement calculation.[66] Thus, only the basis of the building "needs to be doubled . . . for a building to be substantially improved."[67] Additionally, the Treasury explanation of the final regulations "conclude[s] that permitting asset aggregation to a limited extent is appropriate for carrying out 'substantial improvement' determinations."[68] Using the aggregate approach rather than an asset-by-asset approach for substantial improvement "could provide additional compliance flexibility."[69] The Treasury commentary accompanying the final rules also clarifies what activities and expenses count as substantial improvements, including equipment, fees, permits, and necessary infrastructure if associated costs "add[] to the basis of the subject property."[70] This means that "a QOF that intends to substantially improve a hotel may now count the cost of mattresses, linens, furniture, and electronic equipment for purposes of the substantial improvement test."[71] These relaxed requirements may contribute to more interest in real estate projects because they make it less onerous to meet the substantial improvement benchmark.

Next, the structure of the tax incentive encourages projects with a more certain return. Specifically, the OZ program's third potential tax benefit—the complete elimination of tax liability on post-acquisition capital gains—means that the size of the benefit is directly proportional to the return on the project. "In order to take advantage of both the capital gains deferral, and the stepped-up basis components of the Opportunity Zone, Qualified Opportunity Zone Funds are unlikely to invest in projects that are either risky or unlikely to increase in value."[72] Projects with more fixed return such as hotels and other commercial real estate projects are more likely to receive funds.[73] "Small businesses are less likely to receive investor attention given the emphasis on real estate from the investment community."[74] If the generosity of the tax benefit were tiered to provide deeper subsidies for non-real estate business investments, or if the size of the tax cut were somehow tied to impact like the number of jobs created, perhaps there would be less of a real estate tilt.

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66 *See id.* § 1.1400Z2(d)-2(b)(4)(iv).

67 *See* Prop. Treas. Reg. (Background), 83 Fed. Reg. 54279, 54279 (Oct. 29, 2018).

68 Treas. Reg. (Summary of Comments & Explanation of Revisions), 85 Fed. Reg. 1866, 1912 (Jan. 13, 2020).

69 Prop. Treas. Reg. (Explanation of Provisions), 84 Fed. Reg. 18652, 18655 (May 1, 2019).

70 Treas. Reg. (Summary of Comments & Explanation of Revisions), 85 Fed. Reg. at 1913.

71 Nussbaum et al., *supra* note 52.

72 De Barbieri, *supra* note 15, at 140.

73 *Id.*

74 *Id.*

Finally, the existence of other tax benefits could favor real estate projects. For example, NMTC projects are often combined with state and local tax abatement and other federal tax credits.[75] Notably, these tax credits are also geared toward real estate development. This layering of tax benefits can provide the necessary subsidy to move projects forward that could not have occurred in the absence of government support. Often these deals are extremely complicated, and given the similarity between the NMTC and OZ programs, it is possible that OZ deals inherited the expertise developed in structuring NMTC projects.[76] It is unclear the extent to which OZ projects will be able to combine OZ tax benefits with these other breaks for real estate projects, but it seems like investors expect these synergies.[77] By contrast, other tax benefits may be better suited to support the needs of small businesses, including the tax break known as the Qualified Small Business Stock exemption.[78]

C. *The OZ Provisions Are Unfavorable to Startup Investors*

While compliance may be easy for real estate, it is much more complicated for startup investments. Investments in businesses must also meet the substantially all requirement, and there has been considerable debate about the extent to which the substantially all threshold is appropriate. Treasury defended the 70% threshold by noting that it was high enough to keep a substantial amount of investment in the zone but low enough to "ensure that a diverse spectrum of businesses would be able to operate in [Qualified OZs]."[79] Treasury explicitly rejected a 90% threshold as too strict to encourage investment in OZs,[80] though there has been at least one legislative proposal to codify a 90% threshold.[81] In theory, setting a lower threshold could ease restrictions for startup projects. However, even at the 70% threshold, the substantially all requirement has the

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75 Lambie-Hanson, *supra* note 57, at 29 ("The ability to package the NMTC with other credits like [historic-preservation tax incentives and brownfield mitigation incentives] makes real estate deals more attractive and probably contributes to the real estate tilt of the NMTC program.").

76 *See, e.g.*, *Righteous Tax Credit*, FORBES (Nov. 29, 2004, 12:00 AM), https://www.forbes.com/forbes/2004/1129/172.html (describing complex financing structure for project in Buffalo that combines NMTC with historic preservation tax credits in addition to other lending sources).

77 *See* Treas. Reg. (Summary of Comments & Explanation of Revisions), 85 Fed. Reg. 1866, 1914 (Jan. 13, 2020) ("The Treasury Department and the IRS continue to consider the interaction of rules governing other tax incentives (including credits) with section 1400Z–2 and the regulations under section 1400Z–2.").

78 *But see* Jesse Drucker & Maureen Farrell, *Tech Giants Exploit a Tax Dodge for Start-Ups*, N.Y. TIMES, Dec. 29, 2021, Late Edition, at A1 (describing exploitation of Qualified Small Business Stock exemption).

79 Treas. Reg. (Summary of Comments & Explanation of Revisions), 85 Fed. Reg. at 1905.

80 *Id.* at 1906.

81 *See* S. 2787, 116th Cong. § 3 (2019).

potential to create undesirable and complicated compliance barriers for startups but not for real estate projects.

Further adding to the compliance headache for startup projects, under the statute, a qualified OZ business must derive at least 50% of its total gross income from the active conduct of a business within a zone.[82] Specifically, the requirement is satisfied if at least half of the labor input—measured either in terms of hours worked or compensation paid—is located within the zone.[83] Treasury has acknowledged that "[t]he determination of the location of income for businesses that operate in multiple jurisdictions can be complex, and the rules promulgated by taxing authorities to determine the location of income are often burdensome and may distort economic activity."[84] In stark contrast to real estate projects, "[i]f a business acquires additional property outside a low-income community or its workers start providing services or sales in more affluent areas, they may become noncompliant."[85] Thus, there are inherent challenges to tailoring place-based subsidies to businesses that may want to grow and expand. Indeed, "[w]riting rules for investments in businesses was far trickier than for real estate because, unlike buildings, businesses can have operations outside the zone and can move."[86] The OZ program is intended to jump-start business growth, but a business that expands too much can literally grow out of compliance. As a result of these difficult uncertainties, compliance costs are likely higher for business investments, which may explain the real estate tilt.

Another reason that the OZ structure is unfavorable to business investments is the time horizon. To maximize the tax benefits, investors will keep their money in the tract for a decade.[87] In this way, the tool rewards "patient capital" to discourage investors from dumping money into high-return OZs just to reap the tax benefit and quickly exit.[88] In the international development context, patient capital is described as having "all the discipline of venture capital —

[82] *See* I.R.C. § 1397C(b)(2); *id.* § 1400Z-2(d)(3)(A)(ii) (requiring compliance with certain provisions of § 1397C).

[83] Prop. Treas. Reg. (Regul. Plan. & Rev.), 84 Fed. Reg. 18652, 18671 (May 1, 2019); *see* Treas. Reg. § 1.1400Z2(d)-1(d)(3)(i)(A) to (B) (as amended in 2021). There is also a safe harbor if tangible property and management or operational functions located in the OZ are each necessary for at least half of the business's gross income. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(i)(C). Treasury explains that "[t]he provision of alternative safe harbors in these proposed regulations should reduce the compliance and administrative burdens associated with determining whether this statutory requirement has been met." Prop. Treas. Reg. (Regul. Plan. & Rev.), 84 Fed. Reg. at 18671-72.

[84] Prop. Treas. Reg. (Regul. Plan. & Rev.), 84 Fed. Reg. at 18671-72.

[85] Lambie-Hanson, *supra* note 57, at 28.

[86] *See* WESSEL, *supra* note 58, at 140.

[87] *See* I.R.C. § 1400Z-2(c).

[88] *See Opportunity Zones*, ECON. INNOVATION GRP., https://eig.org/opportunityzones/facts-and-figures [https://perma.cc/3RLA-B2Y5] (last visited Apr. 18, 2022) ("[I]nvestors can now choose to roll capital gains over into qualified Opportunity Funds, which in turn channel patient capital into qualifying equity investments in Opportunity Zones for at least a decade in exchange for capital gains tax reductions and possible exemptions.").

demanding a return, and therefore rigor in how it is deployed — but expecting a return that is more in the 5 to 10 percent range, rather than the 35 percent that venture capitalists look for, and with a longer payback period."[89] However, for business development in OZs, the patient capital requirement could actually backfire: the incentives to keep capital in the zone may result in a period of illiquidity that is too long for VC investors who may need to return capital to fund investors in shorter timeframes.[90] Also, the typical investment life cycle of VC funds from the moment they raise capital from investors to the liquidation of the fund is ten years.[91] As such, a fund that is only a few years in existence would be precluded from enjoying the OZ program's maximum tax benefits: those that come from holding investments for a decade.[92] Allowing shorter-term investments for certain investment types could promote more investment in distressed communities, even if the capital is less patient.[93]

Additionally, the program is not particularly suited to meet the needs of small business owners. Notably, the business owners themselves do not receive a tax benefit. This is one way that the OZ program differs considerably from the EZ program, in which small businesses received direct tax credits for hiring local workers.[94] Further, it is possible business owners do not actually want equity

[89] Thomas L. Friedman, Opinion, *'Patient' Capital for an Africa That Can't Wait*, N.Y. TIMES, Apr. 20, 2007, at A23.

[90] A research report by the Urban Institute explains this difficulty:

> These rules create timing issues on both the front and back ends of a QOF when investing in a business, in stark contrast to venture capital. On the front end, investors with a capital gain are looking to deploy immediately, whereas a venture fund wants to obtain capital commitments and draw them only as they are needed. On the back end, OZ investors generally want to stay in a deal for 10 years, to maximize the tax benefit, and exit as soon as possible after that. A venture fund, however, exits an investment whenever the time is right to sell the business to a new investor. This makes it difficult to maintain the minimum capital deployment levels required by the IRS.

THEODOS ET AL., *supra* note 13, at 22.

[91] Andy Rachleff, *Demystifying Venture Capital Economics, Part 1*, WEALTHFRONT (June 19, 2014), https://blog.wealthfront.com/venture-capital-economics/ [https://perma.cc/UJ64-56AJ] ("Venture capital funds are raised in the form of a limited partnership that typically has a mandated 10-year lifespan."); Allen Wagner, *The Venture Capital Lifecycle*, PITCHBOOK (May 14, 2014), https://pitchbook.com/news/articles/the-venture-capital-lifecycle [https://perma.cc/M2TE-ERUS] ("Each fund typically has a lifespan of 8 to 12 years in which to enter into and exit from all of its investments.").

[92] *See* I.R.C. § 1400Z-2(c); *see also* Ronald J. Gilson, *Locating Innovation: The Endogeneity of Technology, Organizational Structure, and Financial Contracting*, 110 COLUM. L. REV. 885, 914 (2010) (noting that FDA approval process was "too long to be feasible for a venture capital fund whose term is typically limited to ten years").

[93] *See* Lambie-Hanson, *supra* note 57, at 31 (observing in NMTC context that "[m]aking the program friendlier to venture capitalists could increase investment in operating businesses" in part because "venture capitalists tend to make investments that are only two or three years in length; these investors often need the flexibility to withdraw equity and sell a company at an opportune time").

[94] *See* Busso et al., *supra* note 7, at 898.

investments in the form of stock or partnership interests that allow funds to qualify. As Aaron Seybert of the Kresge Foundation noted in his congressional testimony, a "mismatch" between minimum investments required by many QOFs and growth equity typically sought by small businesses "creates a problem for many small businesses where the market is trying to deliver a product of scale and many small businesses need something that scales down to the business needs on the ground."[95] If QOFs could provide subordinated debt investment or hybrid debt/equity projects to small businesses, there might be more uptake of those types of projects.[96] Expanding the definition of "qualified opportunity zone business" to include any community development financial institution ("CDFI")[97] could potentially alleviate some of the concerns that "the Opportunity Zone tax incentive is not a good match for the kind of neighborhood revitalization deals of interest to CDFIs, particularly those targeting small businesses."[98]

Next, selection of the zones was not targeted to areas that were particularly ripe for startup investment. Notably, the final statutory language contains no guidance for how governors should make the selections beyond basic eligibility requirements.[99] An earlier version of the bill included specific factors for governors to consider when making the designations, including existing initiatives to attract startup investment and recent business closures.[100] Apparently these instructions were eliminated from the bill to avoid any conflict

[95] *Can Opportunity Zones Address Concerns in the Small Business Economy?: Hearing Before the Subcomm. on Econ. Growth, Tax & Cap. Access of the H. Comm. on Small Bus.*, 116th Cong. 8 (2019) [hereinafter *Opportunity Zone Hearing*] (statement of Aaron Seybert, Managing Director of Social Investments, The Kresge Foundation).

[96] *See* THEODOS ET AL., *supra* note 13, at 34-35.

[97] *See, e.g.*, H.R. 7262, 116th Cong. § 2(a) (2020).

[98] *Opportunity Zone Hearing*, *supra* note 95, at 9 (statement of Jennifer A. Vasiloff, Chief External Affairs Officer, Opportunity Finance Network).

[99] *See* I.R.C. § 1400Z-1(b), (e) (requiring only that selected OZ tract be low-income community or be contiguous with low-income-community OZ and have similar median family income).

[100] The full guidance was as follows:

> When considering the nomination of qualified opportunity zones, governors should strive for the creation of qualified opportunity zones that are geographically concentrated and contiguous clusters of population census tracts and should give particular consideration to areas that—
>
> (1) are currently the focus of mutually reinforcing State, local, or private economic development initiatives to attract investment and foster startup activity,
>
> (2) have demonstrated success in geographically targeted development programs such as promise zones, new market tax credit, empowerment zones, and renewal communities, and
>
> (3) have recently experienced significant layoffs due to business closures or relocations.

Tax Cuts and Jobs Act, S. 1, 115th Cong. § 13823 (as reported by S. Comm. on the Budget, Nov. 28, 2017).

with the Byrd Rule during the reconciliation process.[101] There was no consideration of "education, age structure, local entrepreneurial culture, and physical infrastructure," which are all factors that contribute to successful clusters of entrepreneurship.[102] Selecting places that have strong research universities, for example, could attract startups and promote local economic growth more effectively.[103] Interestingly, some designations around college campuses were specifically criticized because these areas look distressed according to statistics but in reality are filled with full-time students who often have little income.[104] But it is possible that these selections could be more effective in promoting startup growth.[105] The poorly targeted selection of OZs could also explain the program's real estate tilt because "investment in real estate is geographically versatile and thus well suited to benefit from a tax subsidy that applies broadly to hetergeneous [sic] neighborhoods."[106] Additionally, "the widespread availability of data on real estate price trends may help investors to identify investments likely to have higher returns and lower risk."[107]

Finally, the form of the tax benefit itself is not particularly well suited to fostering startup growth. The nature of the tax break is such that investors cannot invest cash; there must be capital gains income to reinvest.[108] The exclusion is not justified by the alleged purpose of the statute and in fact disproportionately limits the pool of potential investors to those with substantial capital gains income.[109] Indeed, it is difficult to imagine a direct expenditure program that would be tied to capital gains in this manner.

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[101] WESSEL, *supra* note 58, at 112-13 ("The Byrd Rule says reconciliation bills cannot include 'extraneous' provisions, defined as those that don't affect federal spending or revenues.").

[102] *See* Aaron Chatterji, Edward Glaeser & William Kerr, *Clusters of Entrepreneurship and Innovation*, 14 INNOVATION POL'Y & ECON. 129, 131, 146-47 (2014).

[103] *See id.* at 137.

[104] *See, e.g.*, Mecia, *supra* note 12, at A13 ("[L]ike many commercial areas adjacent to major colleges, this [Franklin Street] section of Chapel Hill is primed to attract millions of additional dollars in new investment thanks to changes that were part of the 2017 tax law."); *id.* ("The tract has a lot of apartments and rental units—including nearly a dozen fraternity and sorority houses—but the median value of owner-occupied housing is $500,000, or triple the state average.").

[105] *See* Zachery Eanes, *Could Chapel Hill's Opportunity Zone Bring Biotech Startups?*, NEWS & OBSERVER (Raleigh), Dec. 28, 2021, at 7B ("For startups, in particular, [property developer] Grubb believes the Opportunity Zone designation will make it much easier for the companies to attract investors . . . . Grubb is using the designation to redevelop multiple properties along Franklin and Rosemary streets [in downtown Chapel Hill].").

[106] Kennedy & Wheeler, *supra* note 16, at 13.

[107] *Id.* at 14.

[108] *See* I.R.C. § 1400Z-2(a)(1).

[109] WESSEL, *supra* note 58, at 8 ("Fewer than one in five American households has *any* unrealized (that is, unsold and untaxed) capital gains from financial assets, excluding equity in their homes."). The Congressional Black Caucus cautioned against this aspect of the OZ program during the public comment period for the proposed regulations, noting that limiting

II. THE PURPOSE OF THE OZ PROGRAM IS TO PROMOTE STARTUP BUSINESSES

In the previous Part, we described how the OZ program's statutory and regulatory provisions favor real estate over startups. Thus, it may be surprising that the true purpose of the program was initially rooted in the idea of entrepreneurship. This Part describes the OZ idea from conception to enactment, arguing that at every step along the way the intended purpose was to promote startup investment in low-income communities.

OZs started with an idea from Sean Parker, the entrepreneur most famous for his Napster and Facebook ventures.[110] Parker observed the problem of systemic poverty across distressed places in the United States, exacerbated by an uneven recovery from the financial crisis.[111] He saw private investment as essential to the solution and considered different incentives to "get investors to put money into places where they wouldn't normally invest."[112] In March 2015, Parker—along with other high-profile tech entrepreneurs and policy experts—launched a think tank called the Economic Innovation Group ("EIG") to advocate for place-based investment incentives.[113]

In April 2015, EIG released a white paper that outlined the policy proposal more concretely.[114] Consistent with EIG's mission as "a bipartisan public policy organization,"[115] the paper was co-authored by one Democratic economist and one Republican economist.[116] The paper criticized previous federal place-based

eligibility to capital gains income "has the effect of excluding virtually all Opportunity Zone residents and black Americans in general from participating in the benefits of this policy." Cong. Black Caucus Found., Inc., Comment Letter on Proposed Rule on Investing in Qualified Opportunity Funds 2 (Dec. 28, 2018), https://www.regulations.gov/comment/IRS-2018-0029-0130 [https://perma.cc/4NYE-ESMJ].

[110] *See* Bertoni, *supra* note 21.

[111] WESSEL, *supra* note 58, at 27.

[112] *Id.*

[113] *See* Andrea Chang, *Tech Entrepreneurs Launch Think Tank*, L.A. TIMES, Apr. 1, 2015, at C2 ("Priorities include finding new ways to drive private-sector investment to economically distressed communities, promoting new business formation . . . .").

[114] BERNSTEIN & HASSETT, *supra* note 11.

[115] *About Us*, ECON. INNOVATION GRP., https://eig.org/about-us#mission [https://perma.cc/G6PY-H7AK] (last visited Apr. 18, 2022).

[116] *See* BERNSTEIN & HASSETT, *supra* note 11, at 21. Jared Bernstein is currently a member of President Biden's Council of Economic Advisers and also served as the Chief Economist and Economic Adviser to then-Vice President Biden from 2009 to 2011. *New Government: The First 100 Days with Jared Bernstein*, WASH. POST (Feb. 4, 2021, 9:00 AM), https://www.washingtonpost.com/washington-post-live/2021/02/04/new-government-first-100-days-with-jared-bernstein/. Kevin Hassett was the head of the Council of Economic Advisers under President Trump and served as an economic adviser to a number of Republican presidential campaigns. Heather Long, *Meet Trump's Newest Economic Adviser*, CNN (Apr. 10, 2017, 2:15 PM), https://money.cnn.com/2017/04/10/news/economy/kevin-hassett-economic-adviser-trump/index.html [https://perma.cc/6N8R-86ZC].

policies for providing weak and poorly targeted incentives,[117] proposing instead a VC-like structure for pooling investment funds in certain designated distressed communities.[118] The proposal envisioned generous new tax provisions to attract investors, including deferral and elimination of capital gains tax liabilities.[119] The authors also noted that legislation to effectuate the proposal's suggestions "would have to establish a process that identifies target areas in a transparent and orderly fashion, based on objective economic criteria such as the area's unemployment rate, foreclosure rate, labor force participation rate, or even its disaster zone status."[120] As Parker recounts, "[t]he inspiration came from wanting to democratize access to capital and use that as a mechanism to help entrepreneurial people all over the country."[121] Parker also enlisted Andrew Yang as an early proponent, who said EIG's proposed legislation would "[m]ake it easier for investors to roll existing capital into 'Opportunity Funds' that could be invested in early-stage businesses" and who expressed a desire to "make starting businesses in places that need it a little easier."[122]

Next, Parker and EIG had to recruit allies to sell the idea in Congress. Senators Cory Booker and Tim Scott introduced OZs to Congress in 2016 when they filed the Investing in Opportunity Act.[123] The legislation's sponsors issued the following statement when they introduced the bill: "By empowering investors around the country to pool their resources in Opportunity Funds, we can dramatically expand access to the capital and expertise needed to start and grow businesses, hire workers, and restore economic opportunity in struggling communities."[124] Senator Booker praised the proposal for its ability to

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[117] *See* BERNSTEIN & HASSETT, *supra* note 11, at 12 ("[Previous programs] failed to provide a direct incentive either for investing in new companies and small businesses, or for larger investments in infrastructure and capital-intensive industries such as manufacturing . . . .").

[118] *See id.* at 17 (proposing "a structure analogous to that of a venture capital firm or mutual fund company, but specialized in development investments in businesses in predetermined locales").

[119] *See id.* at 18 ("[U]nrealized capital gains might be rolled over into special funds constrained to invest in distressed communities, with the capital gains taxed only if the money is withdrawn from the qualified funds down the road. . . . Depending on how generous Congress would like the incentive to invest to be, the capital gains basis of the unrealized gain could be adjusted/'stepped up' in some manner as well.").

[120] *Id.* at 18-19.

[121] WESSEL, *supra* note 58, at 28.

[122] Andrew Yang, *How the Investing in Opportunity Act Could Help Distressed Communities*, FORBES (Apr. 28, 2016, 11:42 AM), https://www.forbes.com/sites/andrewyang/2016/04/28/investing-in-opportunity/.

[123] WESSEL, *supra* note 58, at 90.

[124] Press Release, Cory Booker, Sen., U.S. Senate, Senators Booker and Scott and Congressmen Tiberi and Kind Introduce the "Investing in Opportunity Act" (Apr. 27, 2016), https://www.booker.senate.gov/news/press/senators-booker-and-scott-and-congressmen-tiberi-and-kind-introduce-the-and-147investing-in-opportunity-act-and-148 [https://perma.cc/S5EA-3L8Y].

"jumpstart economic development and entrepreneurship."[125] In the House, Representatives Ron Kind and Pat Tiberi introduced the same bill.[126] Parker personally met with Representative Tiberi, who served on the House Ways and Means Committee.[127] Tiberi also chaired the Joint Economic Committee, which held a hearing in October 2017 about potential tax reforms to encourage entrepreneurship and startup activity.[128] Various statements reveal the legislators' understanding of the supposed purpose of the OZ program. For example, Tiberi began the hearing by stating that most job creation comes from early-stage startups, citing EIG analysis.[129] Tiberi lamented the decline in the rate of new startup creation and the increasing concentration of new startups in just a few metropolitan areas.[130] He explained that he "introduced the bipartisan Investing in Opportunity Act to attract capital and investment in distressed communities."[131] Senator Martin Heinrich echoed Tiberi's concerns about the increasing concentration of startup activity.[132] He explicitly warned against "tax giveaways for large corporations and our highest earners [that] do nothing to help small businesses, rural communities, and working people, get ahead."[133]

The hearing also featured testimony from policy experts and practitioners in entrepreneurship and tax.[134] The testimony highlighted the OZ program as one possible approach to "simplifying and expanding the favorable tax treatment of investment in new startups."[135] The testimony also offered some justification for targeting the incentives based on place.[136] More broadly, the legislators' statements at the hearing reflected a true belief that place-based incentives could

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[125] *Id.*

[126] WESSEL, *supra* note 58, at 90.

[127] *Id.* at 47. The Ways and Means Committee is the main tax-writing committee in the House. *Id.*

[128] *The Startup Slump: Can Tax Reform Help Revive Entrepreneurship?: Hearing Before the J. Econ. Comm.*, 115th Cong. 1 (2017).

[129] *See id.* (statement of Rep. Patrick J. Tiberi, Chairman, J. Econ. Comm.) ("According to analysis by the Economic Innovation Group, each startup creates an average of six jobs.").

[130] *See id.*

[131] *See id.* at 2.

[132] *See id.* at 3 (statement of Sen. Martin Heinrich, Ranking Member, J. Econ. Comm.) ("One report found that just 20 counties were responsible for half of the net increase in new businesses from 2010 to 2014. . . . [W]e must lay the groundwork for startup activities in rural areas.").

[133] *See id.*

[134] *See id.* at 5-11.

[135] *See id.* at 6 (statement of John R. Dearie, Founder and President, Center for American Entrepreneurship).

[136] *See id.* at 11 (statement of John Arensmeyer, Chief Executive Officer and Founder, Small Business Majority) ("Unfortunately, too many businesses, especially women- and minority-owned firms, and entrepreneurs in distressed and rural communities, are struggling to gain the capital they need to launch or grow their businesses.").

shift investment to overlooked places lacking sufficient access to capital.[137] Overall, the hearing framed OZs as a possible solution[138] to the problem of increased concentration of VC investment.[139] Additionally, the hearing articulated a well-defined purpose: incentivizing startup activity.

Hearing witnesses also cautioned the Joint Economic Committee about certain limitations that would be necessary to administer the program in a manner consistent with this purported purpose. Testimony emphasized the value of "targeted benefits in the Tax Code for *very specific types of investments*, particularly in distressed communities."[140] Nearly a year after the OZ legislation passed, the Senate held another hearing about how to best implement the program to ensure benefits to small businesses;[141] given the timing, the focus was on the importance of clear and tailored rulemaking.[142] The president of EIG testified that "the rules themselves must be from the outset geared to facilitate investment in operating businesses, not simply real estate."[143] The CEO of the Small Business Majority reiterated the same concern.[144] Indeed, the notion that OZs should favor business investment over real estate investment was consistent with Sean Parker's original vision[145] and with EIG's analysis of the

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137 *See, e.g.*, *id.* at 19 (statement of Rep. Francis Rooney, Member, J. Econ. Comm.) ("Since the comment was also made about that people don't locate their business because of taxes, and I would just like to say that if you believe that, then look at Texas, Florida, and Ireland. I have businesses in all of those places.").

138 *See id.* at 29 (statement of Falon Donohue, Chief Executive Officer, VentureOhio) ("[A] program such as the Investing in Opportunity Act is a very smart way to get capital off of the sidelines and into the hands of innovative entrepreneurs who might not have access to capital, such as venture capitalists.").

139 *See id.* at 27 (statement of Rep. John Delaney, Member, J. Econ. Comm.) ("[R]ight now 80 percent of the professionally managed venture capital goes to northern California, New York, and Massachusetts . . . .").

140 *See id.* at 13 (statement of John Arensmeyer, Chief Executive Officer and Founder, Small Business Majority) (emphasis added).

141 *Expanding Opportunities for Small Businesses Through the Tax Code: Hearing Before the S. Comm. on Small Bus. & Entrepreneurship*, 115th Cong. 1-2 (2018) [hereinafter *Expanding Opportunities Hearing*] (statement of Sen. Marco Rubio, Member, S. Comm. on Small Bus. & Entrepreneurship).

142 *See id.* at 12 (statement of John Lettieri, Co-founder and President, Economic Innovation Group) ("[The] central purpose [of OZs] was to drive investment into operating businesses in underserved areas, particularly new ventures and existing small- to medium-sized businesses poised for growth. This fundamental goal must now be reflected in the rulemaking process in order for Opportunity Zones to meet its full dynamic potential.").

143 *Id.* at 13.

144 *Id.* at 20 (statement of John Arensmeyer, Founder and Chief Executive Officer, Small Business Majority) (recommending that "Opportunity Zone guidelines [be] designed to benefit Main Street small business owners rather than focusing on incentivizing real estate development").

145 WESSEL, *supra* note 58, at 28 (quoting Parker as reflecting that "[t]he thinking [behind the OZ program] really had nothing to do with real estate" but rather "new-company creation").

shortcomings of other place-based policies.[146] Thus, it was clear that the purpose was to promote investment in businesses, and it was equally clear that the purpose was *not* to promote investment in real estate.

III. THE IMPACT OF THE OZ PROGRAM ON VC INVESTMENT

The OZ program provides a strong incentive for QOFs to invest in real estate. However, the legislative history reveals an intent to foster startup growth. Thus, the program should be evaluated in light of its purpose of driving startup investment. In this Part, we provide preliminary evidence of the impact of OZ designation on startup investment at the tract level. This Part outlines the empirical strategy, describes the data construction, and presents the results of the analysis.

A. *Empirical Strategy*

To examine the effects of designation on startup investment, we use a difference-in-differences ("DID") research design.[147] This technique is "commonly used in the literature of assessing the effects of legal institutions."[148] The basic DID study begins with data from two groups and two time periods. The first step is to identify a treatment group and a control group. The treatment group is the group that experienced the policy change. Here, the treatment group contains those tracts that were designated as OZs. The control group contains the eligible low-income communities that were not selected as OZs. The second step in a DID analysis is to identify the relevant time periods before and after the policy change. In our case, the introduction of the program was in April 2018,[149] so we take that to be our baseline.

Our model must meet several assumptions to interpret the DID estimator as a causal effect. The first and most critical assumption is the "parallel trends" assumption.[150] The parallel trends assumption states that "in the absence of treatment, the difference between the 'treatment' and 'control' group is constant

[146] *See* BERNSTEIN & HASSETT, *supra* note 11, at 10 ("[A]lthough it supports many different types of investments, more than half of investments through the NMTC are for the development or leasing of real estate as opposed to operating businesses that can, if they survive, have greater potential for expansion and job growth.").

[147] For an overview of the DID technique, see JOSHUA D. ANGRIST & JÖRN-STEFFEN PISCHKE, MOSTLY HARMLESS ECONOMETRICS: AN EMPIRICIST'S COMPANION 227-43 (2009).

[148] John J. Donohue III & Daniel E. Ho, *The Impact of Damage Caps on Malpractice Claims: Randomization Inference with Difference-in-Differences*, 4 J. EMPIRICAL LEGAL STUD. 69, 83 (2007).

[149] Press Release, U.S. Dep't of the Treasury, Treasury, IRS Announce First Round of Opportunity Zones Designations for 18 States (Apr. 9, 2018), https://home.treasury.gov/news/press-releases/sm0341 [https://perma.cc/846G-CNUV].

[150] *Difference-in-Difference Estimation*, COLUMBIA UNIV. MAILMAN SCH. OF PUB. HEALTH, https://www.publichealth.columbia.edu/research/population-health-methods/difference-difference-estimation [https://perma.cc/3TU4-JK4W] (last visited Apr. 18, 2022).

over time."[151] If the parallel trends assumption does not hold, the resulting DID estimator will be biased.[152] Here, OZ and non-OZ tracts may have different levels of investment, but as long as the differences stay constant over time, the trends will be parallel. For the OZ program, the model risks producing a biased DID estimator because governors may have disproportionately selected tracts that were already experiencing high startup growth. However, considering the sheer number of OZ tracts across the country and varying state approaches to OZ selection, it is unlikely that past changes to VC investment differentially affected selection on average. More directly, in a related paper, we find that changes in startup investment that occurred between 2012 and 2017 did not predict OZ selection.[153]

The second assumption that must hold is that the assignment of treatment is unrelated to the outcome of interest.[154] Here, OZ status must be unrelated to post-April 2018 changes in startup activity. Thus, if governors made designations based on expected changes in startup investment, this assumption could be violated. While we cannot conclusively overrule this possibility, there are reasons to believe the assumption holds. As discussed above, governors were ultimately not required to select zones based on expected business growth. Also, there was no differential increase in startup investment immediately prior to selection indicating expected differential future trends. By contrast, we do find evidence that, conditional on distress levels, governors were more likely to select tracts that were trending up in terms of income and down in terms of poverty.

Nevertheless, one or both of our assumptions may not hold because there may be other, unobserved tract-level characteristics affecting startup investment. If this occurs, our estimated treatment effect could be biased because "the control group and the treatment group may have happened to trend in different directions over time for reasons other than the story at hand."[155] In theory, if governors selected zones that were differentially declining in startup investment relative to other eligible tracts, then our estimate would understate the true effect of OZ designation. Conversely, if governors selected zones that were experiencing differential growth in startup investment, then our estimate would overstate the true effect of OZ designation. This is because the estimate would attribute to the program the positive effects that were already occurring or were expected to occur in these zones. In another paper, we established that conditional on distress levels, governors tended to select tracts that were on an upward trajectory.[156] Here, even if the assumptions are violated, the DID estimator would likely

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[151] *Id.*

[152] *Id.*

[153] *See* Eldar & Garber, *supra* note 14, at 39 tbl.2.

[154] *Difference-in-Difference Estimation*, *supra* note 150.

[155] *See* Michael D. Frakes & Melissa F. Wasserman, *Does the U.S. Patent and Trademark Office Grant Too Many Bad Patents?: Evidence from a Quasi-experiment*, 67 STAN. L. REV. 613, 642 (2015) (describing primary concern of parallel trends assumption).

[156] Eldar & Garber, *supra* note 14, at 18.

overstate the impact of the program. Thus, we would interpret the coefficient as an upper bound on the program's impact.

With these assumptions in mind, we proceed to estimate the following model:

$$(1) \qquad Y_{it} = \alpha + \beta \cdot OZ_{it} + \sum_{\tau=1}^{T} \gamma_\tau \cdot I(t=\tau) + \sum_{\tau=1}^{T} \delta_\tau \cdot I(t=\tau) \cdot OZ_{it} + \varepsilon_{it}.$$

Here, Y_{it} is the level of startup investment in tract *i* in time period *t*. OZ_{it} is a dummy variable that is equal to one if tract *t* is a designated opportunity zone. The term $\sum_{\tau=1}^{T} \gamma_\tau \cdot I(t=\tau)$ captures time period fixed effects. We estimate the model for five quarters before and five quarters after the commencement of the OZ program. Finally, the term $\sum_{\tau=1}^{T} \delta_\tau \cdot I(t=\tau) \cdot OZ_{it}$ captures the interaction of the time period fixed effects with the treatment status indicator. Thus, the δ_τ coefficients capture the treatment effects across different time periods before and after the treatment. Prior to OZ designation status, we expect δ_τ to be close to zero; there should be no treatment effect prior to the program's start. However, for the five quarters following OZ selection, we examine the δ_τ coefficients to see the causal effect of designation on startup investment.

B. *Data Construction*

To estimate the DID model, we construct a panel data set. The unit of observation is at the tract level. First, we obtain the list of all designated OZ tracts as well as the list of tracts that were originally eligible for OZ designation. The data on OZs are publicly available from Treasury's website.[157] We exclude from our sample ineligible tracts that likely have different investment trends and other unobservable characteristics that make them unsuitable for the comparison group. Overall, our sample includes 30,981 low-income tracts that were eligible for OZ selection. The treatment group includes 7,657 OZ tracts, which represents 24.7% of all eligible tracts.

Second, we construct the outcome variable of interest—startup investment—utilizing data from VentureXpert. VentureXpert tracks investments by private equity and venture capital firms to specific companies.[158] Specifically, for each funding round covered in the data set, we use the date, total funding amount, recipient company address, and recipient company type. The date includes both the month and year of investment, which is crucial to tracking investment trends over time, both before and after the program. Because the data contain some noise, we aggregate funding rounds in quarters. Using standard geocoding

[157] *Opportunity Zones Resources*, U.S. DEP'T OF THE TREASURY CMTY. DEV. FIN. INSTS. FUND, https://www.cdfifund.gov/opportunity-zones (follow "List of designated Qualified Opportunity Zones" hyperlink) (last updated Dec. 14, 2018).

[158] *See About SDC Platinum*, FORD LIBR., https://library.fuqua.duke.edu/databases/sdcplat.htm [https://perma.cc/CCW4-TUN8] (last visited Apr. 18, 2022).

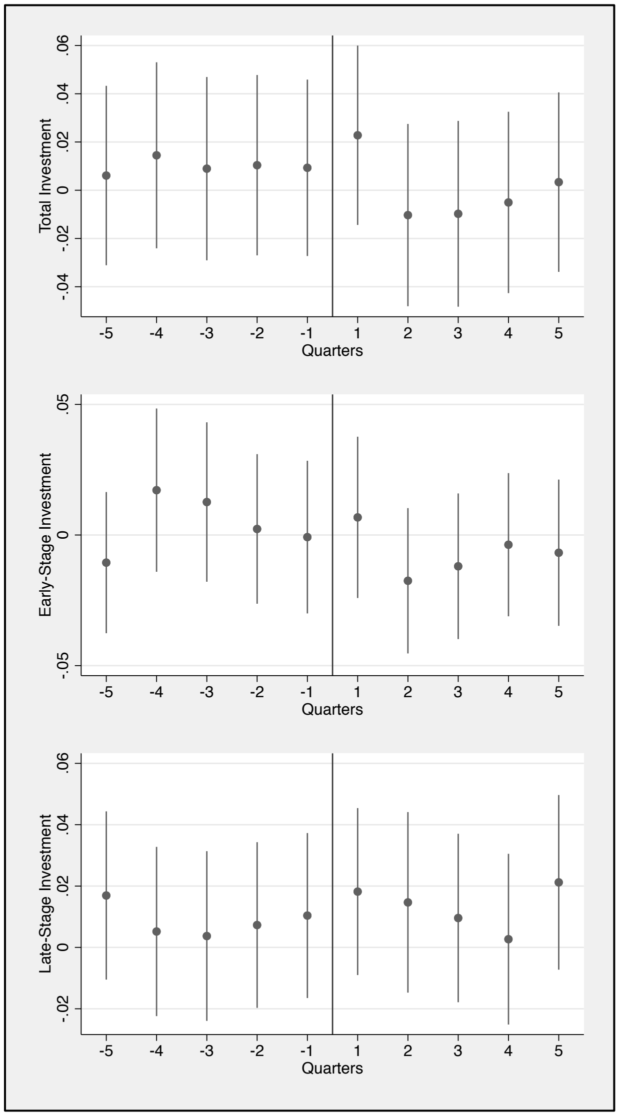
processes,[159] we take each recipient company address and locate it in a specific census tract. We then generate a measure of total startup investment for each tract in each quarter. Finally, we merge this panel to the OZ designation data.

C. *Main Results*

Using the panel data just described, we estimate DID equation (1) above. The results of this exercise are shown in Figure 1.

[159] *Find Batch Address Geographies*, U.S. CENSUS BUREAU, https://geocoding.geo.census.gov/geocoder/geographies/addressbatch?form [https://perma.cc/RRM8-87SC] (last visited Apr. 18, 2022) (providing online geocoder tool).

Figure 1. The Effect of OZ Designation on Startup Investment.[160]



[160] This figure shows the results from the DID model presented in equation (1). Each vertical bar represents the coefficient of interest and the 95% confidence interval. The time frame covers VC investment for five quarters before and after the OZ designations were announced. In the top panel, the outcome is the log of total investment. In the second panel, the outcome is the log of early-stage investment. In the third panel, the outcome is the log of late-stage investment. The estimates can be interpreted as the additional investment experienced by OZ tracts relative to eligible non-OZ tracts in each quarter.

Consider the top panel. Here, the outcome variable is the total startup investment (measured in logs) for five quarters before and five quarters after the OZ designations were first announced. Each vertical bar represents the coefficient and 95% confidence interval for the effect of OZ designation in the given quarter. These coefficients correspond to the δ_τ coefficients in equation (1). Because the outcome variables are in logs, the coefficients are expressed as percentages. Specifically, each point estimate can be interpreted as the *additional* investment experienced by OZ tracts relative to eligible, non-OZ tracts in that quarter. This is the treatment effect of OZ designation on VC investment.

As expected, none of the estimates in the quarters leading up to OZ designation is statistically significant; there should be no treatment effect before the program started. In the first quarter following OZ designation, there is a slight jump in the coefficient. Indeed, the coefficient suggests that there was a 2.28% increase in startup investment in OZs relative to non-OZs in the first quarter of the program.[161] However, we can see that the vertical bar representing the 95% confidence interval for the first quarter contains the value of zero.[162] This means that the detected effect is not statistically significant. Indeed, none of the estimates is statistically significant in the subsequent quarters, either. Thus, across all eligible tracts, there appears to be no detectable effect of OZ designation on total startup investment in our sample period.

Next consider the second and third panels of Figure 1. These panels repeat the same DID model but split the startup investment into early-stage and late-stage investments. Specifically, VentureXpert classifies funds as focusing on various stages including seed, early, later, expansion, and buyout/acquisition.[163] We classify as "early-stage" those funding rounds coded as seed or early by VentureXpert. We classify as "late-stage" those funding rounds coded as later, expansion, or buyout/acquisition by VentureXpert. As shown in the early-stage graph, there is almost no treatment effect after OZ designation. In the first quarter the coefficient is only 0.68%[164]—very close to zero and not statistically significant. Similarly, there is no detectable treatment effect for late-stage investment, as shown in the bottom panel. While there appear to be small jumps in the first and fifth quarters for late-stage investment (1.82% and 2.12%, respectively[165]), the coefficients are not statistically significant.

Our preliminary results suggest that there is no detectable effect of OZ status on VC investment in the five quarters following designation. We view these results as illustrative evidence that the original purpose of the OZ program is not being fulfilled. However, there are some limitations to our analysis, so we

[161] *See infra* Appendix, tbl.1.

[162] The p-value for this estimate is 0.230, confirming that the coefficient is not statistically significant, even at the 10% level.

[163] *See* VENTUREXPERT (accessed using Refinitiv Workspace).

[164] *See infra* Appendix, tbl.1.

[165] *See infra* Appendix, tbl.1.

hesitate to interpret these results as the causal impact of the OZ program. First, the fundamental assumptions underlying the DID analysis may be violated. Our prior paper shows that governors were more likely to select tracts that were on an upward trajectory in terms of median family income and other demographic characteristics.[166] It is possible that, even though we did not see a differential impact of startup trends prior to designation, other observed changes in demographics are leading indicators of investment. Furthermore, there is strong evidence that governors selected zones based on political favoritism toward investors.[167] To the extent that investor favoritism may be a proxy for future investment, the second DID assumption may be violated. However, even if this bias renders our estimates upper bounds, we may still safely conclude that there is no statistically significant treatment effect.

Perhaps more concerning is the limited time frame of our analysis. Due to the data available in VentureXpert, our analysis only covers the fifteen months after OZ designation. This is not necessarily a problem for our analysis because savvy investors usually move quickly in response to tax-efficient business opportunities. Also, as discussed in Part I, the OZ program includes incentives for investing earlier rather than later.[168] However, as discussed in Part I, there was considerable uncertainty among investors about exactly what was required for qualifying investments.[169] This was particularly salient for business investments. Our analysis would not capture the effect of investors waiting until the final regulations came out in early 2020 to make OZ investments in startups. In future work we hope to continue monitoring this impact as more data become available.

D. *Did Political Favoritism Affect Investment Level?*

While OZ tracts do not appear to have experienced an increase in VC investment, in this Section we consider whether tracts that may have been selected as OZs for political reasons experienced such an increase. One heavily criticized feature of the OZ program is the gubernatorial discretion to select zones without meaningful scrutiny, which could allow governors to use OZ designations to reward political supporters.[170] In other words, a politically connected investor (perhaps one who has contributed to the governor's

[166] Eldar & Garber, *supra* note 14, at 18.

[167] *Id.* at 3.

[168] *See* I.R.C. § 1400Z-2(b)(2)(B) (describing 15% reduction in capital gains taxes available only to investors who hold investments for seven years prior to 2026, meaning that investments would have to occur by end of 2019 to maximize benefit).

[169] *See supra* notes 50-53 and accompanying text (describing OZ program's bare statutory framework and investor uncertainty during subsequent rulemaking process).

[170] Eldar & Garber, *supra* note 14, at 2 ("Subsidies may be directed toward areas that have expressed political support for the government. Alternatively, subsidies might be allocated to benefit wealthier investors who already identified business opportunities in [low-income communities]. These political factors fall outside the purview of the purposes of government programs . . . .").

campaign) could lobby for particular areas to be designated as OZs where the investor had already identified "shovel-ready" development projects. However, such investors may also lobby for OZ selections based on readily available startup investment projects. In this way, investor favoritism could serve as a proxy for future investment. Thus, we might expect that OZs associated with investor contributions would be more likely than other OZs to attract VC investment.

In this Section, we extend our empirical analysis from the previous Part to test this hypothesis. We modify equation (1) by adding additional interaction terms to the model, transforming our DID model into a difference-in-difference-in-differences ("triple-diff") model that estimates the *differential* effect that favoritism has on VC investment among designated OZs. Specifically, we estimate the following specification:

(2) $$Y_{it} = \alpha + \beta_1 \cdot OZ_{it} + \beta_2 \cdot FAV_{it} + \beta_3 \cdot OZ_{it} \cdot FAV_{it} + \sum_{\tau=1}^{T} \gamma_\tau \cdot I(t=\tau) + \sum_{\tau=1}^{T} \delta_\tau \cdot I(t=\tau) \cdot OZ_{it} + \sum_{\tau=1}^{T} \theta_\tau \cdot I(t=\tau) \cdot FAV_{it} + \sum_{\tau=1}^{T} \mu_\tau \cdot I(t=\tau) \cdot OZ_{it} \cdot FAV_{it} + \varepsilon_{it}.$$

Many of the variables carry over from equation (1). Y_{it} is the level of startup investment in tract *i* in time period *t*. OZ_{it} is a dummy variable that is equal to one if tract t is a designated opportunity zone. The term $\sum_{\tau=1}^{T} \gamma_\tau \cdot I(t=\tau)$ captures time period fixed effects. The term $\sum_{\tau=1}^{T} \delta_\tau \cdot I(t=\tau) \cdot OZ_{it}$ captures the interaction of the time period fixed effects with the treatment status indicator.

To construct the favoritism proxy, we use campaign contribution data from FollowTheMoney.org to identify all campaign contributions to the governors who were in office at the time of OZ designation.[171] We use information from VentureXpert to identify executives at VC investor firms and investee companies. Then we match these executives based on first and last name to the individual campaign contribution data. Finally, these matched contributions are associated with one or more census tracts based on the location of the investee company. The variable "captures the idea that the investment interests of the investor firms are not where the firms themselves are located but are likely in the neighborhoods where the companies they invested in are located."[172]

We introduce the favoritism variables and relevant interaction terms to the model. FAV_{it} is a dummy variable that is equal to one if tract *t* is associated with investor contributions.[173] The term $OZ_{it} \cdot FAV_{it}$ captures the combined effect of being an OZ with investor contributions on the level of VC investment. The term

[171] *See* FOLLOWTHEMONEY.ORG, https://www.followthemoney.org/ [https://perma.cc/43NA-GKRN] (last visited Apr. 18, 2022) (providing data on campaign contributions in federal and state elections).

[172] Eldar & Garber, *supra* note 14, at 12 (providing details about construction of favoritism variable).

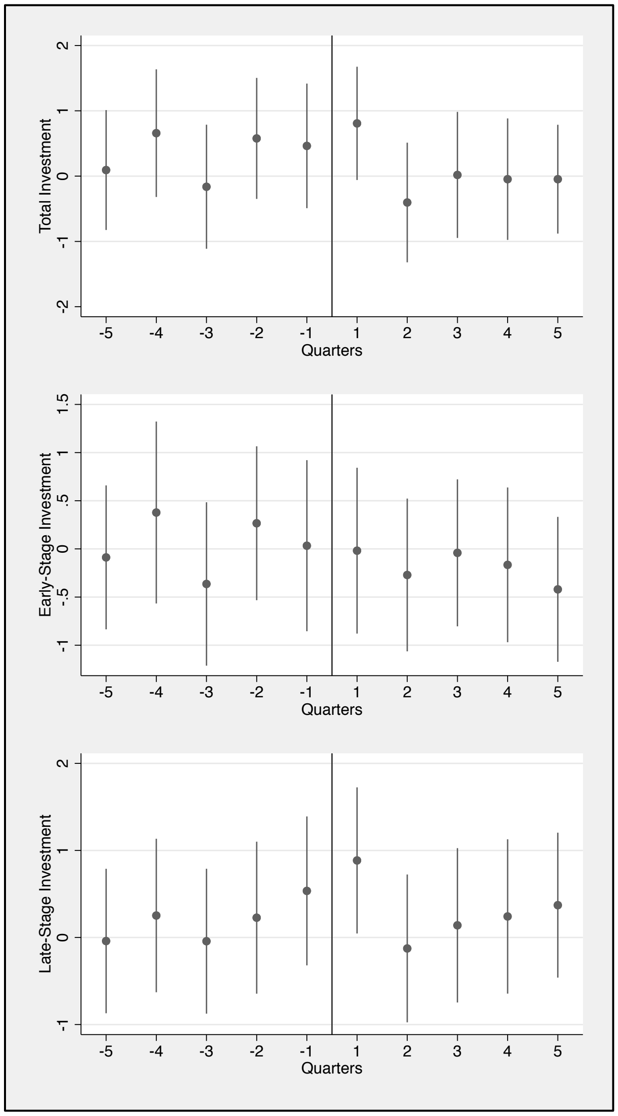
[173] In the full sample of 30,981 tracts, 560 are associated with investor favoritism. *See* Eldar & Garber, *supra* note 14, at 13 tbl.1.

$\sum_{\tau=1}^{T} \theta_\tau \cdot I(t = \tau) \cdot FAV_{it}$ captures a time trend that is specific to tracts associated with favoritism. Finally, $\sum_{\tau=1}^{T} \mu_\tau \cdot I(t = \tau) \cdot OZ_{it} \cdot FAV_{it}$ is the interaction of quarter dummies, OZ status, and favoritism proxy. This is the triple-diff term of interest. Thus, we examine the μ_τ coefficients to determine the differential effect of favoritism among OZ tracts on VC investment in the five quarters before and after the OZ program was up and running.[174]

The results from estimating equation (2) are shown in Figure 2.

[174] For a discussion of the triple-diff framework, see generally Jeff Wooldridge, Lecture at National Bureau of Economics Summer Institute (2007) (presentation available at https://users.nber.org/~confer/2007/si2007/WNE/Slides7-31-07/slides_10_diffindiffs.pdf [https://perma.cc/S2N6-KPYH]). For an example of the regression framework for triple-diff estimation and an application to data, see Jonathan Gruber, *The Incidence of Mandated Maternity Benefits*, 84 AM. ECON. REV. 622, 630-31 (1994).

Figure 2. The Effect of Investor Favoritism on Startup Investment.[175]



175 This figure shows the results from the triple-diff model presented in equation (2). Each vertical bar represents the coefficient of interest and the 95% confidence interval. The time frame covers VC investment for five quarters before and after the OZ designations were announced. In the top panel, the outcome is the log of total investment. In the second panel, the outcome is the log of early-stage investment. In the third panel, the outcome is the log of late-stage investment. The estimates can be interpreted as the additional investment experienced by OZ favoritism tracts relative to OZ nonfavoritism tracts in each quarter.

Consider the top panel. Here, the outcome variable is the total startup investment (measured in logs) for five quarters before and five quarters after the OZ designations were first announced. Each vertical bar represents the coefficient and 95% confidence interval for the effect of OZ designation in the given quarter. These coefficients correspond to the μ_τ coefficients in equation (2). Because the outcome variables are in logs, the coefficients are expressed as percentages. Specifically, each percentage point estimate can be interpreted as the *additional* investment experienced by OZ tracts associated with favoritism ("favoritism OZ tracts") relative to OZ tracts not associated with favoritism ("nonfavoritism OZ tracts") in each quarter. The specification in equation (2) controls for time-invariant characteristics of OZs (β_1) and time-invariant characteristics of favoritism tracts (β_2). The interaction term controls for time-invariant characteristics of tracts that are both OZs and associated with favoritism (β_3). The quarter fixed effects control for the underlying time trends in investment (γ_τ). The second-level interactions control for changes over time in OZ tracts (δ_τ) and changes over time in favoritism tracts (θ_τ).

In the top panel, while there is some noise that reflects the smaller sample of favoritism tracts, we see that in the quarters preceding the OZ program there were no statistically significant effects. Again, this makes sense as we should not expect to see effects of the OZ program before it started. However, in the first quarter following designation, we see an apparently substantial jump. The coefficient suggests that in the first quarter following the program's start, investment in favoritism OZ tracts jumped 80.8% relative to nonfavoritism OZ tracts.[176] While this estimate is not statistically significant at the 5% level, it is significant at the 10% level.[177] Thus, there is a differential impact of designation in favoritism OZ tracts relative to nonfavoritism OZ tracts in the quarter following the OZ announcement.

The bottom two panels split the outcome variable into the log of early-stage investment and the log of late-stage investment. A quick glance at these two panels reveals that late-stage investment is driving the entire effect we see on total investment. The coefficient in the first quarter after designation suggests that favoritism OZ tracts experienced 88.5% *more* investment than nonfavoritism OZ tracts in that quarter.[178] This estimate is statistically significant.[179] Notably, even late-stage investment dips back down to the baseline beginning in the second quarter. This means that the only detectable effect of OZ designation status on VC investment is occurring in a small number of tracts associated with investor favoritism. This raises a concern that these investment projects would have occurred without the subsidy and thus that the OZ tax benefits are not spurring any new investment but rather are sweetening the deal for projects that would have happened anyway. Additionally, even

[176] *See infra* Appendix, tbl.2.

[177] The p-value for the estimate at the 10% level is 0.068.

[178] *See infra* Appendix, tbl.2.

[179] The p-value for the estimate is 0.039.

where investment did occur, it was concentrated in late-stage investment. This is contrary to the purpose of the OZ program, which is supposedly "to drive investment into operating businesses in underserved areas, particularly new ventures and existing small- to medium-sized businesses poised for growth."[180]

E. *Where Are the Tax Benefits Flowing? (Answer: Real Estate)*

While money does not appear to have been flowing to startups,[181] there is substantial evidence that OZ investment was occurring, even in the immediate months following the program's start. However, these investments were flowing to real estate projects. Numerous news outlets reported real estate developments that were purportedly getting the OZ tax benefit.[182] For example, a private equity firm in Phoenix immediately began raising millions for three projects: "a 130-room Marriott hotel with furnishings by West Elm; 81 single-family townhomes with a swimming pool and clubhouse; and a 90-unit apartment complex near Arizona State University's campus in Tempe."[183] Similarly, as of 2019, the Kushner family owned or was purchasing at least a dozen properties in OZs, including "a pair in Miami, where Kushner Companies plan[ned] to build a 393-apartment luxury high rise with sweeping views of Biscayne Bay."[184] Another investment company, owned by former White House Communications Director Anthony Scaramucci, was "using the opportunity-zone program to help build a new hotel, outfitted with an opulent restaurant and a rooftop pool, in the trendy

[180] *See Expanding Opportunities Hearing*, *supra* note 141, at 12 (statement of John Lettieri, Co-founder and President, Economic Innovation Group).

[181] Naturally, some startups have benefited from the OZ program. *See, e.g.*, Stephen Babcock, *Galen Robotics Investment Shows How the Opportunity Zone Program Can Fund Startups*, TECHNICAL.LY (Nov. 11, 2019, 6:16 PM), https://technical.ly/2019/11/11/galen-robotics-verte-investment-opportunity-zone-fund-startups/ [https://perma.cc/UMJ8-HFU2] (describing Baltimore-based surgical robotics company that received OZ investments to expand operations and hire local workers). However, these expansions likely would have happened but for subsidization. *See* WESSEL, *supra* note 58, at 224-25 (noting that same company moved to Baltimore "without any serious attention to the OZ tax break" and CEO considered OZ tax incentive "basically icing on the cake"). Despite a few isolated examples, on balance the anecdotal evidence suggests that the OZ incentive does not benefit startups. *See id.* at 274 (concluding that idea "that the OZ tax break would direct billions to start-up businesses in depressed neighborhoods, seeding the next Facebook or Apple in gritty parts of Baltimore or Chicago, is—so far—more fantasy than reality").

[182] For a long list of particularly egregious examples, see Eldar & Garber, *supra* note 14, app. at B2-B5. By contrast, there are some laudable instances of OZ money flowing to create affordable housing. *See, e.g.*, WESSEL, *supra* note 58, at 242-46 (describing how social-impact-focused property management firm in Los Angeles raised $115 million from OZ investors, with plan to build more than 1,200 affordable housing units).

[183] Ruth Simon & Richard Rubin, *New Hotel or Affordable Housing? Race Is On to Define 'Opportunity Zones,'* WALL ST. J. (July 13, 2018, 5:30 AM), https://www.wsj.com/articles/new-hotel-or-affordable-housing-race-is-on-to-define-opportunity-zones-1531474200.

[184] Yaffe-Bellany, *supra* note 12 (citation omitted).

Warehouse District of New Orleans."[185] Clearly, certain investors did not hesitate to jump on OZ tax breaks for real estate projects, many of which may have already been in progress prior to the OZ sweetener.

Beyond this anecdotal evidence, and despite the lack of reporting requirements in the statute, there is some limited data on actual OZ investment. Researchers working with the congressional Joint Committee on Taxation received access to confidential IRS data on OZ investments for electronic filers in tax years 2019 and 2020.[186] The analysis reveals a high level of geographic concentration in OZ investments—roughly 63% of the designated tracts received zero investment and the top 1% of tracts received 42% of all total investment.[187] Furthermore, among designated tracts, OZ investors favored tracts that were less distressed along several dimensions including poverty and unemployment.[188] OZ investors also favored tracts that were on an upward trajectory in terms of income and firm growth, suggesting that investments may have flowed to the tracts that were already attracting investment in the absence of OZ tax incentives.[189] The data also reveal the types of projects OZ investors favor. Overall, OZ funding skews heavily toward real estate investments, with over half of OZ dollars funneling into real estate firms.[190] In fact, "both residential and non-residential real estate businesses attract considerable OZ investment."[191]

OZ investors' general preference for real estate is also corroborated by other data sources. According to data collected by a national professional services organization, residential and commercial development are the leading investment areas.[192] By contrast, QOFs that focus on operating businesses had raised only about 2% of the total amount of money raised by the funds as of September 2021.[193] A survey conducted by EIG in May 2020 also confirmed the tilt toward real estate—over 60% of respondent OZ stakeholders said their funds were focused on real estate investments.[194]

[185] *Id.*

[186] Kennedy & Wheeler, *supra* note 16, at 3.

[187] *Id.* at 10-11.

[188] *Id.* at 26.

[189] *See id.* at 28 ("This evidence suggests that OZ tracts receiving investment from QOF funds were experiencing substantially different trends in economic activity relative to all tracts nationally and relative to OZ tracts that did not receive investment.").

[190] *See id.* at 12 ("[A]pproximately 52% of OZ dollars are invested in real estate firms, while 11% is invested in construction firms, and 9% in finance.").

[191] *Id.*

[192] Michael Novogradac, *Novogradac Opportunity Fund Tracking Surpasses $20 Billion*, NOVOGRADAC (Oct. 22, 2021, 12:00 AM), https://www.novoco.com/notes-from-novogradac/novogradac-opportunity-fund-tracking-surpasses-20-billion [https://perma.cc/UX4F-VMNB].

[193] *See id.*

[194] *State of the Opportunity Zones Marketplace: The Impact of COVID-19*, ECON. INNOVATION GRP. (June 23, 2020), https://eig.org/news/state-of-the-opportunity-zones-

IV. REPURPOSING THE OZ PROGRAM

In the prior parts we established that there is a strong mismatch between the stated purpose and the actual terms of the OZ program. While the legislative history reveals an intent to support entrepreneurship, the statute and regulations were structured in such a way that the program "basically turned into a real estate tax credit."[195] Since the OZ program began, there have been several bills introduced in Congress to change or fix OZs. Although the Biden Administration has yet to make concrete changes to the OZs, it has signaled support for a more tailored, limited version of the program.[196] Making thoughtful and timely reforms to the program should be a more urgent priority because President Biden's plan to increase the top capital gains tax rate[197] could unintentionally drive more investment into OZs as investors look to avoid large tax liabilities.[198] In this Part, we describe proposals introduced in the current and recent sessions of Congress and evaluate whether they improve the fit between the purpose and the program.

The first category of proposals addresses the program's lack of transparency and reporting requirements. For example, Senators Cory Booker and Tim Scott introduced a bill to require Treasury to collect data on OZ investments, including the total amount, date, type of investment, and location.[199] This proposal sought

marketplace-oz-survey [https://perma.cc/EB74-Q78R] ("Mixed-use and residential real estate were the most commonly targeted asset classes . . . .").

[195] *See* Zipper, *supra* note 27.

[196] *See* Jason Bisnoff, *After Rocky Start, Opportunity Zones Could Boom in 2021*, FORBES (Jan. 15, 2021, 3:07 PM), https://www.forbes.com/sites/jasonbisnoff/2021/01/15/after-rocky-start-opportunity-zones-could-boom-in-2021/ ("[T]he potential exists for a more regulated, targeted and monitored version of opportunity zones to take off—particularly in a climate of rising tax rates and cities ravaged by Covid-19."); Jim Tankersley, *Biden Revisits a Trump-Era Tax Break*, N.Y. TIMES, Apr. 22, 2021, at B1 ("The Biden administration is weighing how to overhaul a Trump-era tax incentive that was pitched as a way to drive investment to economically depressed swaths of the country but which early evidence suggests has primarily fueled real estate development in areas like Brooklyn neighborhoods that were already becoming richer and whiter.").

[197] *See generally* DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2023 REVENUE PROPOSALS 30-36 (2022) (providing overview of President Biden's capital gains tax reform proposals).

[198] Noah Buhayar & Ben Steverman, *Biden's Capital Gains Hike Could Sweeten This Trump Tax Break*, BLOOMBERG (Apr. 30, 2021, 10:30 AM), https://www.bloomberg.com/news/articles/2021-04-30/biden-s-capital-gains-hike-could-sweeten-this-trump-tax-break.

[199] *See* S. 1344, 116th Cong. § 1 (2019). A companion bill was also introduced in the House. H.R. 2593, 116th Cong. (2019). Several other, similar bills were introduced to improve OZ accountability. *See, e.g.*, S. 2994, 116th Cong. § 1 (2019) ("'Improving and Reinstating the Monitoring, Prevention, Accountability, Certification, and Transparency Provisions of Opportunity Zones' or the 'IMPACT Act'"); H.R. 5011, 116th Cong. § 1 (2019) ("Opportunity Zone Accountability and Transparency Act"); S. 2787, 116th Cong. § 1 (2019) ("Opportunity Zone Reporting and Reform Act").

Notably, in the late stages of publication for this Essay, Senator Cory Booker again introduced a bill that would reinstate and expand the reporting requirements for OZs. *See* to require reporting on "the impacts and outcomes of zone designation in those areas on economic indicators, including job creation, poverty reduction, new business starts, and other metrics";[200] another would require reporting on how OZ investments affect different racial and ethnic groups within the zone.[201] There is broad consensus that the OZ program should be more transparent. Congress should be clear about the intended beneficiaries of the program and what economic benefits they are receiving.[202] Annual reporting should require detailed data, and this data should be publicly available.[203] Impact reporting in terms of job creation could follow the model of reporting requirements for NMTC projects,[204] and certification for QOFs could also follow the NMTC model as some members of Congress apparently initially intended.[205] However, it is not clear that any of these reforms would better align the program with the purpose of encouraging startup investment because they do not actually change the terms of the program.

The second category of bills extends or expands the current program. Members of Congress have proposed increasing the maximum number of OZs in each state from 25% to 30% of low-income communities,[206] extending the deferral period for paying the tax on reinvested capital gains,[207] and allowing the redesignation of OZs every ten years.[208] Other proposals have focused on

S. 4065, 117th Cong. §§ 1, 201 (2022) ("Opportunity Zones Transparency, Extension, and Improvement Act"). Representative Ron Kind filed a companion bill in the House. *See* H.R. 7467, 117th Cong. §§ 1, 201 (2022) ("Opportunity Zones Improvement, Transparency, and Extension Act"). In addition to including reporting requirements, the bill also proposes to disqualify OZs with a high median family income and to extend the deferral period by two years. *See* S. 4065 §§ 101, 301; H.R. 7467 §§ 101, 301.

[200] *See* S. 1344 § 1(a)(5).

[201] *See* H.R. 4999, 116th Cong. § 1(a) (2019).

[202] De Barbieri, *supra* note 15, at 100.

[203] Experts from Georgetown University and the Federal Reserve created a comprehensive framework for collecting OZ data; this framework should be implemented. *See* OZFRAMEWORK, https://ozframework.org [https://perma.cc/YT48-B2EE] (last visited Apr. 18, 2022).

[204] *See* NEW MKTS. TAX CREDIT COAL., NEW MARKETS TAX CREDIT PROGRESS REPORT 8 (2021), https://nmtccoalition.org/wp-content/uploads/2021-progress-report-1.pdf [https://perma.cc/2X4F-ZNQL] ("Projects generated 45,090 jobs in 2020, including 28,322 full-time equivalent (FTE) jobs and 16,768 temporary construction jobs.").

[205] *See* H.R. REP. NO. 115-466, at 538 (2017) (Conf. Rep.) (detailing in conference committee's joint explanatory statement of Tax Cuts and Jobs Act conference report that provision in Senate's pre-conference version "intend[ed] that the certification process for a qualified opportunity fund . . . be done in a manner similar to the process for allocating the new markets tax credit").

[206] *See* H.R. 4177, 117th Cong. § 2 (2021).

[207] *See* H.R. 970, 117th Cong. § 2 (2021) (extending deferral period by two years); H.R. 4177 § 2 (extending deferral period by three years); H.R. 6513, 116th Cong. § 1 (2020) (extending deferral period by four years).

[208] *See* H.R. 1852, 116th Cong. § 2(a) (2019); H.R. 4608, 117th Cong. § 2(a) (2021).

expanding the number of OZs to include tracts in federally declared disaster zones[209] and tracts located on Indian land.[210] However, expanding the current program would only reinforce the existing problems and could exacerbate the real estate tilt. For example, it is doubtful that increasing the number of OZs in each state would tailor the program to more startup investment unless the additional tracts were chosen in a more nuanced way.[211]

The third category of bills restricts the OZ program. For example, Senator Ron Wyden introduced a bill that would have prohibited certain property types from being considered qualified OZ business property, including "self-storage property, stadium property, or disqualified residential rental property."[212] A similar bill introduced in the House added "parking property" to Senator Wyden's list of excluded OZ business property types.[213] Expanding the list of disqualified real estate projects would be a very direct way to fix the real estate tilt, but it still may not address the shortcomings of OZs to the extent that the incentives are not attractive to startup investors. Congress could prohibit real estate projects altogether, but some distressed communities may be in desperate need of certain types of real estate investment. Congress could also be very specific about what types of real estate projects are allowed, such as affordable housing, mixed-use space for offices, and business incubator space for startups. For instance, one House proposal included a requirement that QOFs meet certain benchmarks for affordable housing investments.[214] However, while increasing affordable housing stock is an important policy goal, it may not be possible to effectively incentivize both affordable housing and startup investments under a one-size-fits-all program. Of course, if the OZ program is too broad, there is always the option to scrap it; indeed, Representatives Rashida Tlaib and Pramila Jayapal introduced a proposal in the last legislative session to repeal the OZ program altogether.[215] It is also worth noting that the OZ designations are set to expire on December 31, 2028; thus, another political strategy may simply be to allow the provisions to expire through the sunset clause.[216]

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[209] *See* H.R. 1851, 116th Cong. § 2(a) (2019).

[210] *See* H.R. 7000, 115th Cong. § 10(a) (2018).

[211] *See* Chatterji et al., *supra* note 102, at 148 (noting that recent entrepreneurship research examines "access to customers and suppliers, access to required labor inputs, and access to ideas or technology" as part of determining "how amenable to entrepreneurship a local area is" in terms of such factors).

[212] *See* S. 2787, 116th Cong. § 6(c) (2019). Residential property would have been disqualified "unless 50 percent or more of the residential units . . . [were] both rent-restricted . . . and occupied by individuals whose income [was] 50 percent or less of area median income." *Id.*

[213] *See* H.R. 5042, 116th Cong. § 5(c)(1)(B) (2019).

[214] *See* H.R. 4999, 116th Cong. § 1(a) (2019).

[215] *See* H.R. 5252, 116th Cong. § 1(a) (2019).

[216] *See* I.R.C. § 1400Z-1(f) ("A designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation."); Brett Kimbro, *When Do*

The fourth category of proposals supplements the OZ program by encouraging specific types of business investments. For example, one proposal would have expanded the definition of "qualified opportunity zone business" to include certain small businesses affected by COVID-19.[217] Another proposal sought to expand the definition of "qualified opportunity zone business" to include any CDFI.[218] Proposals like these could expand the pool of eligible businesses significantly and could also ease some of the compliance concerns for startup investments. The CDFI proposal was also directly responsive to concerns of small business owners, who may need access to technical support and lending instead of equity investments.[219]

The final category of proposals layers additional incentives on top of the investor tax breaks. One example is the Incentivizing Investment and Job Creation in Opportunity Zones Act of 2019, which specifically encouraged manufacturers to locate production in OZs by offering them additional tariff refunds.[220] Another example is the Recent Grads in Start-Ups and Innovation Act, which encouraged recent graduates to locate small businesses in OZs by allowing no-interest deferral of student loan payments.[221] These bills actually incentivized locating businesses in OZs by providing a direct benefit to the business or business owner. Related bills have given explicit preference to OZs in allocating financial assistance to business incubators[222] and in awarding grants to workforce training programs for high school students to enter high-demand industries.[223]

Notably, all of the bills in the final two categories directly or indirectly promoted business investments. However, they arguably do not go far enough. For example, recent scholarship on entrepreneurship describes one Obama Administration initiative comprised of "proposals to increase access to capital, enhance entrepreneurial education and mentorship, limit regulatory barriers to starting and growing companies, spur technology commercialization efforts from universities, and open up entrepreneurial opportunities in key industries like healthcare, energy, and education" as "'setting the table' for high-growth entrepreneurship."[224] Few of the OZ proposals incorporate "setting the table" activities that could establish proper "baseline business environments."[225]

Opportunity Zones Expire?, REALIZED (Aug. 19, 2021), https://www.realized1031.com/blog/when-do-opportunity-zones-expire [https://perma.cc/WPU2-YBXT] (noting expiration date of December 31, 2028).

217 *See* H.R. 6529, 116th Cong. § 2(a) (2020).

218 *See* H.R. 7262, 116th Cong. § 2(a) (2020).

219 *See supra* notes 95-98 and accompanying text (describing mismatch between current OZ provisions and typical small business needs).

220 *See* H.R. 3390, 116th Cong. § 2 (2019).

221 *See* H.R. 6579, 115th Cong. § 2 (2018).

222 *See* H.R. 4931, 116th Cong. § 2 (2019).

223 *See* H.R. 6995, 115th Cong. § 2 (2018).

224 *See* Chatterji et al., *supra* note 102, at 157-58.

225 *See id.* at 131.

Proposals aimed at establishing such environments could address factors that may promote entrepreneurship and innovation at the city level, such as education, age structure, local entrepreneurial culture, and physical infrastructure.[226] Proposals to cultivate "assets, like strong research universities or pro-business policies, that [may] engender growth and attract start-ups" may be more effective at improving the fit between the OZ purpose and the OZ program.[227]

In summary, while there is an emerging consensus that the OZ program is in need of reform, most of the proposals introduced so far fail to address the program's fundamental defect—the mismatch between its goal and its implementation. And the two proposals that actually sought to make the OZ program more useful for startup entrepreneurs still fell short of the program's ambitious goal of uprooting economic distress in low-income communities. For any reform proposal to have a meaningful impact, it must start with a clear definition of the program's purpose and a detailed analysis of how the program, as amended, will further this articulated purpose. While this is a remarkably low bar for success, the existing OZ framework and the reform proposals introduced so far do not appear to meet it.

V. A NOTE ON THE LEGISLATIVE PROCESS OF DEVELOPMENT PROGRAMS

If the future of the OZ program is indeed as bleak as it currently seems, it raises the question of why similar programs appear to have been better designed and also had better outcomes. Consider, for example, the creation of the CDFI Fund in 1994.[228] The CDFI Fund encourages economic growth in distressed communities by offering tailored resources to certified institutions that commit to serving low-income communities.[229] Specifically, the program "achieves its goals by directly investing in, supporting, and training CDFIs that provide loans, investments, financial services, and technical assistance to underserved populations and communities."[230] There is broad consensus that the CDFI program has been largely successful at injecting capital into these neighborhoods.[231] We suggest that one reason for this success is that the

[226] *See id.* at 146-47.

[227] *See id.* at 137.

[228] Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 104, 108 Stat. 2160, 2166-70 (codified as amended at 12 U.S.C. § 4703).

[229] *See* Ofer Eldar, *Designing Business Forms to Pursue Social Goals*, 106 VA. L. REV. 937, 979-85 (2020).

[230] Kristle Romero Cortés & Josh Lerner, *Bridging the Gap? Government Subsidized Lending and Access to Capital*, 2 REV. CORP. FIN. STUD. 98, 102 (2013).

[231] *See, e.g.*, *id.* at 123 (concluding that "loan growth increases by 3% of assets at credit unions that receive CDFI Fund grants"); Eldar, *supra* note 229, at 983 ("The evidence suggests that the CDFI program generally achieves its goals, such as serving new client populations and geographic markets, developing new services, expanding the scale of services, developing new products, expanding existing lending or investing programs, and improving self-sufficiency ratios over time.").

legislative process was deliberate and transparent, whereas the legislative process that preceded the OZ program's creation was rushed and opaque.[232]

There is substantial evidence that the legislative process that resulted in the creation of the CDFI Fund was careful and thorough. After the initial introduction of the bill, "[t]he Banking Committee's action [reporting the bill favorably] followed 3 hearings on community development lending."[233] A congressional report outlined the "problems associated with lack of access to credit and investment capital,"[234] reviewed in great detail the role of CDFIs in solving those problems,[235] and thoroughly described the proposed legislation.[236] The result of this careful process was a clear purpose clause in the CDFI statute: "The purpose of this subchapter is to create a Community Development Financial Institutions Fund to promote economic revitalization and community development through investment in and assistance to community development financial institutions, including enhancing the liquidity of community development financial institutions."[237] The Act itself sets forth—in lengthy, detailed provisions—the fundamentals of the program that allow the Act to meet this purpose.[238]

By contrast, the OZ program was described as a "little-noticed section" in the massive Tax Cuts and Jobs Act.[239] During the markup phase of the tax bill, the OZ proposal received little scrutiny: "Opportunity Zones were never mentioned once. No member of Congress questioned whether they were a good idea or heard anyone critique the details."[240] Thus, the OZ statute contains no statement of its purpose and leaves most of the substantive details to Treasury to fill in via regulations.[241] The result of the rushed legislative process and vague statute is

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[232] Professor Roberta Romano studies an analogous question in the context of corporate governance mandates of the Sarbanes-Oxley Act, offering the following question: "What were the political dynamics that produced legislation in which Congress enacted a set of mandates that in all likelihood will not achieve the professed goal of the legislation . . . ?" Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1543 (2005). She characterizes the process as "low-quality decisionmaking," noting that Congress was "unaware of the disconnect between legislative means and ends." *Id.* at 1544.

[233] S. REP. NO. 103-169, at 4 (1993).

[234] *Id.* at 6-7.

[235] *Id.* at 9-13.

[236] *Id.* at 13-21.

[237] 12 U.S.C. § 4701(b).

[238] *Id.* §§ 4701-4719.

[239] *See* Tankersley, *supra* note 10, at B1.

[240] WESSEL, *supra* note 58, at 108.

[241] *See supra* Section I.A (describing sparse statutory framework of OZ program); Samantha Jacoby, *Opportunity Zones Exemplify 2017 Tax Law's Fundamental Flaws*, CTR. ON BUDGET & POL'Y PRIORITIES (Nov. 1, 2019), https://www.cbpp.org/blog/opportunity-zones-exemplify-2017-tax-laws-fundamental-flaws [https://perma.cc/9QHJ-FF3Z] ("The hasty drafting and enactment of the 2017 law, which passed without public hearings or broad expert input, gave wealthy investors and lobbyists even more ways to benefit by leaving key

that the success of the OZ program was left "up to Treasury as it draft[ed] rules to interpret an ambiguous statute that [could not] properly function as written."[242] Furthermore, the reconciliation process may not be an appropriate route for passing development programs at all, as "reconciliation bills cannot include 'extraneous' provisions, defined as those that don't affect federal spending or revenues."[243] Key provisions giving guidance to governors in selecting the zones and describing reporting requirements for QOFs were stripped from the bill because it was passed through reconciliation.[244] Thus, the rushed legislative process may have seriously undermined the purpose of the program and may have delegated too much implementation responsibility to Treasury.

Future research should examine more seriously the political economy involved in enacting development programs. Evaluating the shortcomings of the OZ legislative process as compared to those of other programs like the CDFI Fund may provide insight into a more effective design.

CONCLUSION

The OZ program has attracted a great deal of criticism over its efficacy and lack of transparency. We argue that the core deficiency of the program is that it lacks a clearly defined purpose. It was initially created to spur entrepreneurial activity and support small businesses in low-income areas, but as implemented it appears to primarily benefit real estate investors. Our preliminary empirical evidence on VC investment flows to OZs and anecdotal evidence on real estate projects in OZs confirm this intuition. We suggest that this mismatch between the original purpose of the program and its impact so far is the result of a hasty and opaque legislative process, and we argue that any legislative reform should articulate a clear purpose for the program and tailor the program's terms to fulfill this purpose.

We do not profess to argue that spurring entrepreneurship is necessarily a loftier or more desirable goal than promoting real estate investments. Intuitively, replicating the success of Silicon Valley startups in distressed communities sounds ideal, but doing this at the scale envisaged by the OZ program may be overly ambitious. Further, some real estate projects surely yield benefits for local

decisions to the Treasury Department and the IRS as they write the regulations implementing it.").

242 Adam S. Wallwork & Linda B. Schakel, *Primer on Qualified Opportunity Zones*, 159 TAX NOTES 945, 971 (2018).

243 *See* WESSEL, *supra* note 58, at 112.

244 Mary Burke Baker, Adam J. Tejeda & Edward Dartley, *Senators Introduce Report-Card Legislation to Measure the Impact of Opportunity Zone Investments*, NAT'L L. REV. (May 21, 2019), https://www.natlawreview.com/article/senators-introduce-report-card-legislation-to-measure-impact-opportunity-zone [https://perma.cc/SBQ3-4DB6] ("The reporting requirements were eliminated from the tax reform bill due to the Byrd Rule, a feature of the budget reconciliation process that was used during tax reform . . . . The Byrd Rule prohibits provisions that do not have a budgetary impact.").

residents and small businesses. There is a need for more studies assessing what types of business activities best enhance growth in distressed communities and what subsidies are needed to promote such activities. The key claim of our Essay is a modest one. Any development program must have some theory of the types of activities that it seeks to promote, and its terms should actually give incentives for business planners to pursue these activities.

APPENDIX

Table 1. The Effect of OZ Designation on Startup Investment.

	(1) Total Investment	(2) Early-Stage Investment	(3) Late-Stage Investment
Quarter -5	0.00609	-0.0106	0.0169
	(0.0190)	(0.0138)	(0.0140)
Quarter -4	0.0145	0.0172	0.00519
	(0.0197)	(0.0159)	(0.0141)
Quarter -3	0.00895	0.0126	0.00371
	(0.0194)	(0.0156)	(0.0141)
Quarter -2	0.0104	0.00233	0.00730
	(0.0191)	(0.0146)	(0.0138)
Quarter -1	0.00930	-0.000792	0.0104
	(0.0187)	(0.0149)	(0.0137)
Quarter 1	0.0228	0.00676	0.0182
	(0.0190)	(0.0157)	(0.0139)
Quarter 2	-0.0103	-0.0175	0.0147
	(0.0193)	(0.0142)	(0.0150)
Quarter 3	-0.00977	-0.0120	0.00959
	(0.0197)	(0.0142)	(0.0140)
Quarter 4	-0.00506	-0.00371	0.00268
	(0.0192)	(0.0140)	(0.0142)
Quarter 5	0.00336	-0.00677	0.0212
	(0.0190)	(0.0143)	(0.0145)
N	340791	340791	340791
R^2	0.438	0.395	0.377

Note: This table shows the coefficients for δ_t from equation (1).
Standard errors in parentheses are clustered at the tract level.
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Table 2. The Effect of Investor Favoritism on Startup Investment.

	(1) Total Investment	(2) Early-Stage Investment	(3) Late-Stage Investment
Quarter -5	0.0932	-0.0882	-0.0405
	(0.468)	(0.381)	(0.423)
Quarter -4	0.658	0.378	0.253
	(0.499)	(0.482)	(0.450)
Quarter -3	-0.163	-0.364	-0.0426
	(0.485)	(0.433)	(0.425)
Quarter -2	0.577	0.266	0.228
	(0.473)	(0.408)	(0.445)
Quarter -1	0.463	0.0332	0.535
	(0.487)	(0.453)	(0.436)
Quarter 1	0.808*	-0.0184	0.885**
	(0.443)	(0.439)	(0.428)
Quarter 2	-0.404	-0.271	-0.125
	(0.468)	(0.405)	(0.433)
Quarter 3	0.0182	-0.0411	0.140
	(0.492)	(0.389)	(0.452)
Quarter 4	-0.0469	-0.165	0.242
	(0.475)	(0.410)	(0.452)
Quarter 5	-0.0469	-0.420	0.371
	(0.425)	(0.384)	(0.425)
N	340791	335654	335654
R^2	0.439	0.409	0.392

Note: This table shows the coefficients for μ_t from equation (2).
Standard errors in parentheses are clustered at the tract level.
* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$