Key Elements of the U.S. Tax System

What are Opportunity Zones and how do they work?

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A. Opportunity Zones are tax incentives to encourage those with capital gains to invest in low-income and undercapitalized communities.

HOW DO OPPORTUNITY ZONES WORK, WHO CAN CLAIM THE INCENTIVES, AND WHAT PROJECTS CAN THEY SUPPORT?

The Tax Cuts and Jobs Act included a new federal incentive—Opportunity Zones—meant to spur investment in undercapitalized communities. Any corporation or individual with capital gains can qualify. The program provides three tax benefits for investing unrealized capital gains in Opportunity Zones:

- **Temporary deferral of taxes on previously earned capital gains**. Investors can place existing assets with accumulated capital gains into Opportunity Funds. Those existing capital gains are not taxed until the end of 2026 or when the asset is disposed of.
- **Basis step-up of previously earned capital gains invested**. For capital gains placed in Opportunity Funds for at least 5 years, investors' basis on the original investment increases by 10 percent. If invested for at least 7 years, investors' basis on the original investment increases by 15 percent.
- **Permanent exclusion of taxable income on new gains**. For investments held for at least 10 years, investors pay no taxes on any capital gains produced through their investment in Opportunity Funds (the investment vehicle that invests in Opportunity Zones).

Investors can take advantage of one or more of the benefits.

Apart from a few "sin" businesses, Opportunity Funds can finance a broad variety of activities and projects. Funds can finance commercial and industrial real estate, housing, infrastructure, and existing or start-up businesses. For real estate projects to qualify for Opportunity Fund financing, the investment must result in the properties being "substantially improved."

WHICH COMMUNITIES ARE ZONES AND WHAT ARE THEIR ATTRIBUTES?

Twelve percent of US census tracts are Opportunity Zones (8,762 tracts). Governors of the 50 states and 4 territories and the mayor of Washington, DC, nominated the zones, which were officially designated by the US Department of the Treasury. The statute contains no provision to change which communities are classified as Opportunity Zones.

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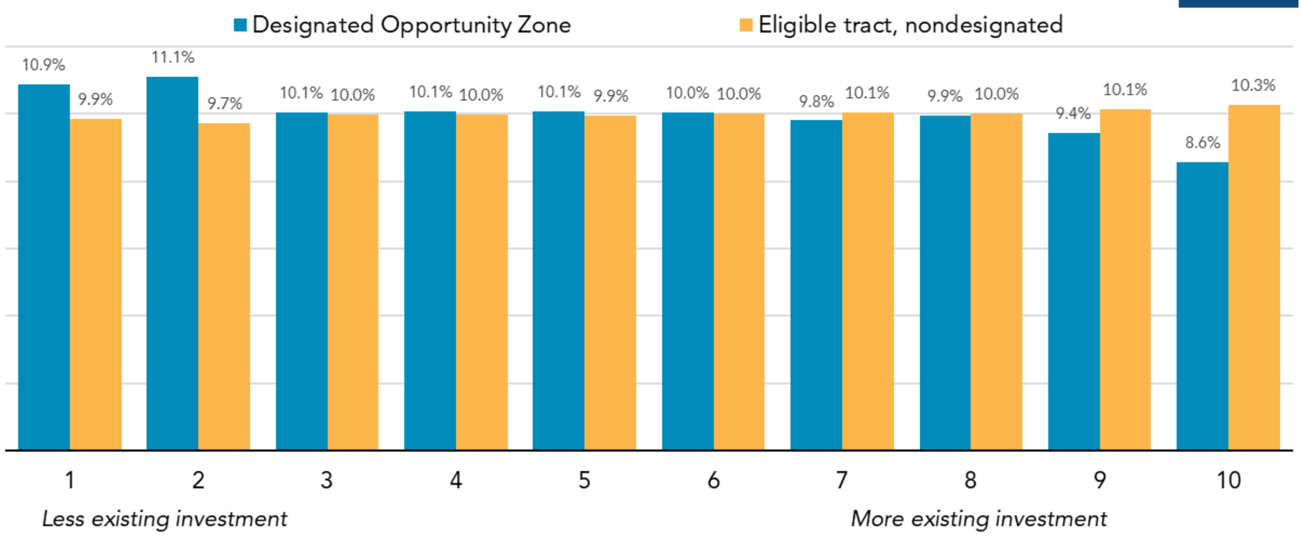
Urban Institute research finds that the designated zones have lower incomes, higher poverty rates, and higher unemployment rates than eligible nondesignated tracts. However, analysis shows minimal targeting of the program toward disinvested communities.

Urban ranked Opportunity Zone investment on a 1 to 10 scale, standardized across eligible tracts state by state, with 10 being the highest score. Just under one-third of Opportunity Zones are located in the three tracts that have the least investment, while 28 percent are in the three tracts attracting the most investment. This pattern is roughly similar to nondesignated tracts, with only very slight targeting toward lower-investment areas (figure 1).

FIGURE 1

Investment Score Distribution of Opportunity Zones



Sources: Urban Institute analysis of 2011–15 CoreLogic, 2015 Longitudinal Employer Household Dynamics Origin-Destination Employment Statistics Workplace Area Characteristics, 2011–15 US Census Bureau American Community Survey, 2000 US Census Decennial Census, 2011–15 Home Mortgage Disclosure Act, and 2011–15 Community Reinvestment Act data.
Note: This figure excludes US territories.

Opportunity Zones seem better targeted when measured by socioeconomic standards. Designated tracts have lower incomes, more poverty, and higher unemployment than eligible nondesignated tracts. Home values, rents, and homeownership rates also are lower. The designated tracts are less white and more Hispanic and black. Ages are similar while education levels are somewhat lower. The mix of urban and rural Opportunity Zones closely tracks community patterns (table 1).

Finally, we looked how designated tracts changed from 2000 to 2016. Where communities are already experiencing high levels of socioeconomic change, further investment may displace low- and moderate-income residents. Thus, Opportunity Zones in these areas may be less likely to benefit needy residents. We measured socioeconomic change by tracking changes in the share of residents with a bachelor's degree or higher, median family income, share of non-Hispanic white residents, and average housing costs as a share of income.

We found that tracts experiencing socioeconomic change were more represented among designated tracts (3.2 percent) than among eligible nondesignated tracts (2.4 percent).

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TABLE 1

Tract Characteristics by Opportunity Zone (OZ) Designation Status

Characteristics	Designated	Eligible, nondesignated
Economic (average $ or average %)		
Median household income	$33,345	$44,446
Poverty rate	32%	21%
Unemployment rate	13%	9%
Housing (average $ or average %)		
Median home value	$145,187	$170,919
Median rent/month	$768	$885
Homeownership	45%	57%
Severe rent burden	26%	24%
Vacancy rate	16%	14%
Demographic (average %)		
White alone	40%	55%
Black alone	24%	17%
Hispanic	30%	20%
Asian Americans and Pacific Islanders alone	3%	4%
Younger than 18	24%	23%
Older than 64	14%	15%
Education (average %)		
Age 25+ with high school degree or less	55%	50%
Age 25+ with bachelor's degree or higher	38%	43%
Geography (%)		
In a metro area	78%	79%
In a micro area	11%	11%
Non–core-based statistical area	10%	10%

Source: CDFI Fund, Urban Institute analysis of 2012–16 US Census Bureau American Community Survey.
Note: This table includes all 50 states, the District of Columbia, and Puerto Rico. It does not include American Samoa, Guam, Northern Mariana Islands, and the Virgin Islands due to data limitations.

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Data Sources

Community Development Financial Institutions Fund.

Federal Financial Institutions Examination Council. Community Reinvestment Act Data.

———. Home Mortgage Disclosure Act Data.

US Census Bureau. American Community Survey.

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Further Reading

Theodos, Brett, Brady Meixell, and Carl Hedman. 2018. "Did States Maximize Their Opportunity Zone Selections?" Washington DC: Urban Institute.
