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Policy Actions to Expand Opportunity Zones in the States

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TOPLINE POINTS

- ★ The federal Opportunity Zones (OZs) program is a pro-growth tax incentive that has spurred private investment and economic development in many of America's most distressed communities.
- ★ States can amplify the effectiveness of OZs by undertaking several reforms, including ensuring that the state tax code conforms with the federal code.
- ★ States can also create their own Opportunity Zone Plus enhancements that boost the reward for investing in rebuilding America's forgotten communities and solving tough problems like the housing affordability crisis.

Introduction

The Opportunity Zones (OZs) program, established under the Tax Cuts and Jobs Act of 2017 (Public Law No. 115-97), is designed to spur economic development and job creation in economically distressed communities through tax incentives that encourage long-term private investment. The following provides a high-level overview of the OZs initiative and explores options for expanding it at the state level. The goal is to inform state and federal elected officials, public sector and private sector leaders, and communication strategists about potential policy options and their implications for maximizing the impact of OZs.

Background

OZs are a key element of federal economic policy aimed at revitalizing economically disadvantaged communities across the United States. The program allows investors to defer and reduce taxes on capital gains by reinvesting those gains in designated OZs through an investment vehicle called a Qualified Opportunity Fund (QOF). These zones are economically distressed census tracts nominated by state governors and certified by the U.S. Department of the Treasury, offering investors an incentive to invest in long-term, sustainable projects. During the OZ designation process in 2018, many governors prioritized designating OZs that were distressed and whose designation would be received positively by the community, government, and business.

Nearly 8,800 census tracts across all 50 states, the District of Columbia, and five U.S. territories were designated as OZs. Based on tax return data from the Internal Revenue Service, as of 2022, these zones have attracted significant private capital, with QOFs raising about $84 billion (Joint Committee on Taxation, 2024). Investments have been directed toward a variety of projects, including housing, commercial real estate, manufacturing businesses, and start-ups, to name a few, all contributing to economic revitalization in some of the Nation's most underserved communities.

State Policy Recommendations and Examples

The OZ tax incentive has shown promising results, and there are opportunities to expand its reach and increase its effectiveness. Expanding OZs could provide critical support to more newly distressed or previously overlooked communities. Enhancing the incentives associated with OZs could also attract more private capital and encourage more meaningful investments in existing zones.

- **Conform state taxes with federal OZ tax incentive**

While investors received a series of *federal* tax benefits for investing in businesses in the designated OZs, investors still faced *state* taxes upon harvesting a capital gain and utilizing the federal program. To resolve this, policymakers in many states decided to make their state tax code "conform" with the federal OZ program. Investors in states with full conformity receive state tax benefits that are aligned with the OZ tax incentive. Conversely, states that do not fully conform penalize investors and make it more challenging to attract OZ investments there. Policymakers in states that do not fully conform with the federal OZ tax incentive should align their state tax code so that investors are not dissuaded from investing. For states without income taxes, policymakers could consider alternative inducements, such as sales tax incentives. For example, an investor could receive a tax credit for sales taxes paid on the tangible property invested in the OZ.

Example: Indiana has full conformity (Ind. Code § 6-3-1-11). Conversely, California does not conform (Cal. Rev. & Tax. Cd. § 17024.5(a)(1)). Texas does not have an income tax and, therefore, could look to other taxes to incentivize investing, as highlighted in the next option.

- **Develop state-level incentives to enhance federal tax benefits**

State policymakers could introduce additional tax incentives to enhance federal OZ tax benefits. This could include offering state tax credits, deductions, or exemptions for investments in OZs, particularly for projects that align with state economic development goals. State-level tax incentives could make OZs more attractive to investors by reducing the overall tax burden and increasing the return on investment. This could lead to more substantial and diverse investments in local communities, promoting economic growth and job creation.

Example: Ohio implemented a non-refundable tax credit equal to 10 percent of the amount of equity funds invested in Ohio OZs, subject to program restrictions. Generally, investors may apply the tax credit to Ohio income taxes, carry unused credits forward, or sell all or part of the tax credit (Ohio Rev. Code § 122.84).

- **Opportunity Zone Plus: Even stronger incentives for high-impact investments and reforms**

States can create "Opportunity Zone Plus" (OZ+) programs—targeted enhancements to grant and tax programs—or provide other forms of enhanced support to encourage high-impact projects in OZs that achieve policy goals. These enhanced state grants and support programs can guide investments toward projects that provide significant social and economic benefits to OZ communities. This approach ensures that investments address critical needs and contribute to long-term community development.

The policy goals could focus on (i) *what* is being invested in or (2) *where* the investment takes place. For example, policymakers could add OZ+ benefits for:

(1) Creating workforce housing or affordable housing, workforce development centers, healthcare facilities, or other critical infrastructure that directly benefits local communities.
(2) Investing in the most distressed OZs or attracting more capital to rural communities in need.

In addition, OZ communities could have the opportunity to earn different "OZ+ badges" by reducing hurdles to each type of impact investment, which would unlock even stronger incentives for investors making that type of impact investment. For example, an investor who created workforce housing in a highly regulated area could receive an OZ+ incentive, but an investor who created workforce housing in an area that takes active steps to reduce the regulatory burden could receive an even *greater* benefit. This structure would simultaneously reward localities for being good partners and ensure that money is flowing to areas where it can be most cost-efficient.

The OZ+ benefits could differ depending on the state's tax structure. In Ohio, for example, if state policymakers elect to direct investment into the most distressed or rural OZs, the state could increase the incentives of its tax credit program: A 15 percent tax credit (as described above) for investments in Ohio's most distressed OZs or a 20 percent tax credit for investments in Ohio's rural OZs.

Conclusion

The OZ tax incentive has demonstrated significant potential as a tool for economic development in distressed communities. By taking proactive steps to enhance the program at the state level, policymakers can amplify its impact, bringing more investment and opportunity to areas in need. Decision-makers are encouraged to adopt a strategic, data-driven approach to expanding OZs, ensuring that the benefits of this initiative reach those most in need while encouraging economic development and investment in a way that benefits the community in the long term.

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