Tucked Into the Tax Bill, a Plan to Help Distressed America

Michael Tubbs, the mayor of Stockton, Calif., hopes a provision in the new federal tax law will help entice investment to the city.Credit...Andrew Burton for The New York Times

By Jim Tankersley

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WASHINGTON — A little-noticed section in the $1.5 trillion tax cut that President Trump signed into law late last month is drawing attention from venture capitalists, state government officials and mayors across America.

The provision, on Page 130 of the tax overhaul, is an attempt to grapple with a yawning hole in the recovery from the Great Recession: the fact that, in huge swaths of the country, the economic recovery has yet to arrive.

The law creates "Opportunity Zones," which 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. The provision is the first new substantial federal attempt to aid those communities in more than a decade. And it comes as a disproportionate share of economic growth has been concentrated in so-called superstar metropolitan areas like Los Angeles and New York.

If the zones succeed, they could help revitalize neighborhoods and towns that are starved for investment.

They could also deliver a windfall, in the form of avoided capital gains taxes, for corporations and financiers who invest in the Opportunity Zones.

Yet risks remain, including whether investors will steer dollars toward areas that really need investment.

The zones were included in the tax law by Senator Tim Scott, a South Carolina Republican who was born into poverty in North Charleston, and based on a bill he co-sponsored in 2017 with several Democrats. The effort to create the zones was pushed by an upstart Washington think tank, the Economic Innovation Group, and its patron, the tech mogul Sean Parker, of Napster and Facebook fame, who enlisted Mr. Scott and others to sponsor the legislation.

Image
Senator Tim Scott, Republican of South Carolina, helped get a provision into the $1.5 trillion tax overhaul that aims to stimulate investment in distressed areas through "Opportunity Zones."Credit...Pete Marovich for The New York Times

“I had to explain it several times to folks,” said Mr. Scott, whose co-sponsors on a previous iteration of an opportunity zone bill included Senator Cory Booker, Democrat of New Jersey, and House lawmakers from both parties. “I came out of one of these communities, so I believe that there’s untapped potential in every state in the nation.”

Mr. Scott said that he had discussed the plan with Mr. Trump and that the president had later spoken approvingly of it. But in the rush to pass the bill over the course of a few frenzied weeks, the idea was never debated on the floor of the House or Senate. It was never promoted by Republican leaders or the White House.

“This is a little billion-and-a-half dollar part” of the law, Kevin Hassett, the chairman of Mr. Trump’s Council of Economic Advisers, said in an interview. “But if it’s successful, we’ll look back 10 years from now and say this was one of the most important parts of the tax bill, and one we didn’t talk nearly enough about.”

Mr. Hassett has a longtime interest in providing tax incentives for economic development in distressed areas. He said he first began discussing opportunity zones with Mr. Parker several years ago at a meeting in Mr. Parker’s Greenwich Village home. Before joining the Trump administration, Mr. Hassett wrote several white papers to help elevate the idea as part of an extensive, multiyear effort by the Economic Innovation Group to win support.

Mr. Hassett said he was never paid for any of that work. His interest, he said, stems from growing up near Turners Falls, Mass., which has struggled since the closing of its longtime paper mills.

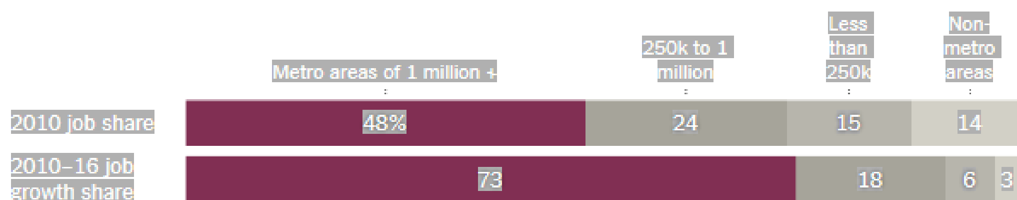
Mr. Parker, who made his fortune as the first president of Facebook, was looking for a way to steer investors to parts of America that have been starved for economic activity in the wake of the Great Recession.

One in six Americans lives in what the Economic Innovation Group calls a “distressed community,” where median household incomes remain far below the national level, which is $59,000 a year, and the poverty rate is well above the national average. Those communities are urban, rural and suburban. On average, the communities lost 6 percent of their jobs and a similar share of their business establishments from 2011 to 2015, according to census data.

Kevin Hassett, chairman of the Council of Economic Advisers, helped push for the creation of Opportunity Zones for communities still struggling to recover from the recession.Credit...Alex Wong/Getty Images

The national economy grew and added jobs during that period, but that growth was disproportionately in large cities. Metropolitan areas with at least one million residents provided just under half of America's jobs in 2010. But from 2010 through 2016, those metropolitan areas accounted for nearly three-quarters of the country's net job creation, according to new research by the Metropolitan Policy Program at the Brookings Institution in Washington.

Rural areas accounted for just 3 percent of the job growth in that time. From 2010 to 2014, according to the innovation group's research, rural areas saw more businesses close than open.



Economic development professionals in those areas have struggled to attract the attention of companies and venture capitalists, who channel most of their money to major cities. To bring

those investors into distressed communities "you have to hit them in their sweet spot, and their sweet spot is, they pay a lot of capital gains taxes," said Donald Hinkle-Brown, president and chief executive of Reinvestment Fund, a community development group.

The new tax law provision plays to that sweet spot. It instructs governors in each state and territory, along with the mayor of the District of Columbia, to designate Opportunity Zones from a pool of low-income, high-poverty census tracts, subject to certification by the Treasury secretary. States cannot nominate all their qualifying tracts for that status — they are limited to only a quarter of eligible tracts. Investors, like banks or hedge funds, then create Opportunity Funds to seed either new businesses in those areas, expansions of existing ones or real estate development.

The people who invest in Opportunity Funds are able to minimize their tax burden through preferential treatment of capital gains.

More than $2 trillion in unrealized capital gains are sitting on individual and corporate balance sheets across America, according to the Economic Innovation Group, the result of profitable investments in stocks and mutual funds. Normally, the proceeds from the sale of those assets would be taxed as a capital gain, at a maximum federal rate of 20 percent plus a 3.8 percent surtax. The new law offers investors an alternative: to roll those unrealized gains into an Opportunity Fund, and defer federal taxes on the profit, at least temporarily.

That deferral grows into capital gains tax relief the longer the investment is held. An investor who retains an investment for seven years will pay only 85 percent of the capital gains taxes that would have been due on the original investment. If the investment is held beyond 10 years, the investor permanently avoids capital gains taxes on any proceeds from the Opportunity Fund investment.

The waterfront in Stockton. The mayor wants parts of the city to be designated as federal Opportunity Zones to attract investment.Credit...Andrew Burton for The New York Times

“This becomes its own asset class, and it could be a very large asset class,” Mr. Parker said in an interview, referring to Opportunity Funds.

Investors are already starting to take notice. A two-hour session on Opportunity Funds drew a standing-room-only crowd last week at the Winter Innovation Summit in Salt Lake City, said Patrick McKenna, founding partner of the venture capital firm High Ridge Global. Mr. McKenna has invested in distressed communities such as Baltimore and over the last year has tried to steer Silicon Valley dollars to struggling areas such as Youngstown, Ohio, out of a belief those areas contain untapped potential for growth and prosperity.

Civic leaders are beginning to pitch state economic development officials on designating tracts of their communities as Opportunity Zones. “It’s very exciting,” said Michael Tubbs, the mayor of Stockton, Calif., which the Economic Innovation Group ranks as the eighth-most distressed large city in America. “It makes communities like Stockton more attractive for investment.”

Turning distressed communities into attractive investments, however, is not a guarantee. One critique of the plan is that it might not leverage much investment in areas that really need it — be they Stockton, or Youngstown, or any other distressed community. Research suggests many previous federal attempts to increase investment in particular regions, such as Clinton-era Enterprise Zones, were largely ineffective. A more successful effort was the New Markets Tax

Credit, a program that still exists and similarly gives incentives to invest in distressed areas but that is relatively limited in scope.

Proponents say the new Opportunity Zones are designed to be more effective than earlier programs, and likely to generate far more investment than congressional scorekeepers predicted in assessing the tax bill. The Joint Committee on Taxation predicted the provision would reduce tax revenues by $1.6 billion over 10 years, suggesting a modest amount of additional capital gains investment.

State economic development officials worry that if they designate the wrong areas as Opportunity Zones, they could end up subsidizing investments that were in the pipeline anyway.

"Job one is getting the areas correct and really levering this, in the intent of the program," said Stephanie Copeland, executive director of the Colorado Office of Economic Development and International Trade. "Not just making venture capitalists more money."

Mr. Parker said he planned to educate fund managers on how to best capitalize on the possibilities in distressed areas.

"Eventually," he said, "I think it's important that I put my money where my mouth is by investing in Opportunity Funds myself." He said that he expected it would take a year or two for the funds to catch on, but that the results would exceed expectations once they did.

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