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Volume 62 | Issue 6 Article 5

6-29-2021

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Recommended Citation

Michelle C. Perry, *A State-Level Response to Ineffective Federal Place-Based Investment Tax Incentives*, 62 B.C. L. Rev. 1969 (2021), https://lawdigitalcommons.bc.edu/bclr/vol62/iss6/5

A STATE-LEVEL RESPONSE TO INEFFECTIVE FEDERAL PLACE-BASED INVESTMENT TAX INCENTIVES

Abstract: Using tax expenditures, the federal government can deploy economic incentives to alter our choices in the service of public policy goals. Doing so reduces not only federal but also state tax revenue because state tax law often conforms to definitions of income contained in the Internal Revenue Code. State governments, however, may not have the same goals as Congress, so tax incentives implemented nationally may not always be a good fit for states. This Note focuses on tax expenditures directing private investments into low-income neighborhoods, known as federal place-based investment tax incentives. It argues that because their impact is ambiguous at best, state governments should scrutinize such incentives and decouple state tax law from these provisions when they hurt the local communities they purport to help. This Note then proposes a framework to assist states in evaluating the local impact of federal place-based investment tax incentives. The framework asks three questions: 1) whether the federal provisions allow states to measure their effects; 2) whether states have the administrative capabilities to establish rigorous evaluation procedures; and 3) whether measures are in place to minimize the costs of these incentives while promoting the equitable distribution of their benefits.

INTRODUCTION

Taxation is a revenue-raising tool without which the U.S. government could not conduct the business of governing.[1] Satisfying the need for revenue is, however, only part of the story.[2] In addition to direct spending and regulations, Congress also provides tax breaks—known in policy circles as "tax ex-

[1] C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY 15 (Jeffrey Butts et al. eds., 2004). Justice Oliver Wendell Holmes famously called taxes the price "we pay for a civilized society." Compania General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting). In the early days after the Revolutionary War, under the Articles of Confederation, the inability to collect taxes forced the federal government to depend on financial donations from states. Mystica M. Alexander & Timothy Gagnon, *The Roberts Court: Using the Taxing Power to Shape Individual Behavior*, 23 U. FLA. J.L. & PUB. POL'Y 345, 346–47 (2012). By 1783, this system of taxation proved untenable in the face of mounting debts incurred during the Revolutionary War. Calvin H. Johnson, *The Panda's Thumb: The Modest and Mercantilist Meaning of the Commerce Clause*, 13 WM. & MARY BILL RTS. J. 1, 11 (2004). Although the members of the 1787 Constitutional Convention disagreed on many issues, they agreed unanimously to grant Congress the "Power to Lay and collect Taxes." Alexander & Gagnon, *supra*, at 347; *see also* U.S. CONST. art. 1, § 8, cl. 1 (granting Congress taxation power).

[2] *See* STEUERLE, *supra* note 1, at 1 (describing taxation's role in supporting government spending as the "tip of the iceberg").

penditures"—to encourage particular behaviors and activities.[3] Tax expenditures change behavior by changing economic incentives.[4] When the United States faced an affordable housing shortage in the 1980s, Congress enacted the Low-Income Housing Tax Credit (LIHTC) under the Tax Reform Act of 1986 to induce private actors into building more low-income housing, especially in poor neighborhoods.[5] Congress reasoned, and hoped, that real estate developers would be more inclined to build affordable housing if tax credits offset the cost of construction.[6] Now, the LIHTC far exceeds any other federal initiative in providing housing for low-income families, and it is entirely administered through the tax system.[7] Indeed, trillions of dollars of foregone tax revenue go

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[3] Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 711 (1970); *see* Ruth Mason, *Federalism and the Taxing Power*, 99 CALIF. L. REV. 975, 981 (2011) (discussing how Congress uses taxing and spending decisions to regulate behavior). Tax scholarship credits this concept to Stanley Surrey's seminal critique of tax expenditures published in the 1970s. Susannah Camic Tahk, *Everything Is Tax: Evaluating the Structural Transformation of U.S. Policymaking*, 50 HARV. J. ON LEGIS. 67, 68 (2013); *see* Surrey, *supra*, at 734–38 (arguing that tax expenditures are generally flawed and less effective than direct expenditures).

[4] Mason, *supra* note 3, at 981; *c.f.* OFF. OF TAX ANALYSTS, U.S. DEP'T OF TREASURY, TAX EXPENDITURES 1 (2020) [hereinafter TAX EXPENDITURES] (explaining that the repeal of a tax expenditure influences economic behavior by changing incentives). One simple illustration of a tax expenditure considers the alternative motor vehicle tax credit. *See* Tahk, *supra* note 3, at 70 (discussing how the government increasingly turns to tax incentives to further energy policy objectives in lieu of establishing new regulatory agencies and direct spending). Tax credits offsetting the purchase price may tempt more consumers to buy a fuel-efficient car. *Id.* With that in mind, Congress included the alternative motor vehicle tax credit when it passed energy policy legislation in 2005. *See* I.R.C. § 30B(a)(1), (b)(1)(D) (providing up to $40,000 in "new qualified fuel cell motor vehicle" credits); Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (describing the purpose of the Act). Tax expenditures pursuing this and other energy policies now exceed the entire budget of the Department of Environment and Energy. *Compare* TAX EXPENDITURES, *supra*, at tbl.1 (estimating energy tax expenditures as totaling approximately $14.3 billion for 2019), *with* MARK FEBRIZIO ET AL., REGULATORS' BUDGET: HOMELAND SECURITY REMAINS KEY ADMINISTRATION PRIORITY 4 (2019) (estimating the budget for the Department of Environment and Energy as totaling approximately $8.3 billion in 2019). Other areas where the federal government employs tax expenditures include national defense; international affairs; research and development in science, space, and technology; energy production and consumption; conservation of natural resources and the environment; agriculture; commerce and housing; transportation; education; training, employment, and social services; health; income security; social security; veteran affairs; bond markets; and aid to state and local governments. TAX EXPENDITURES, *supra*.

[5] *See* Rebecca Diamond & Tim McQuade, *Who Wants Affordable Housing in their Backyard? An Equilibrium Analysis of Low-Income Property Development*, 127 J. POL. ECON. 1063, 1064 (2019) (noting that housing subsidies induce changes in housing construction); Myron Orfield, *Racial Integration and Community Revitalization: Applying the Fair Housing Act to the Low-Income Housing Tax Credit*, 58 VAND. L. REV. 101, 131 (2005) (discussing the history of the Low-Income Housing Tax Credit (LIHTC)).

[6] *See* Diamond & McQuade, *supra* note 5, at 1064 (discussing the incentive effect of housing subsidies on private actors).

[7] U.S. GOV'T ACCOUNTABILITY OFF., GAO-18-637, LOW-INCOME HOUSING TAX CREDIT: IMPROVED DATA AND OVERSIGHT WOULD STRENGTHEN COST ASSESSMENT AND FRAUD RISK-MANAGEMENT 1 (2014) [hereinafter GAO-18-637]. In 2017, the LIHTC represented $8.4 billion in forgone tax revenue. *Id.*

towards nudging taxpayers to modify their behavior in a way that serves goals in the purview of federal agencies outside of the Department of the Treasury (Treasury).[8]

When Congress uses its taxation power to regulate behavior, it not only makes decisions for the federal government but also for the states—without their consent.[9] Because states with an income tax often tax their residents using figures from federal tax returns, Congress reduces state tax revenue when providing federal tax breaks.[10] It often passes these measures to regulate activities historically under state control.[11] Being that federal tax expenditures reflect national priorities, states should pause to consider the effects of such expenditures on not only their budgets but also on their autonomy to set state tax policy.[12]

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[8] *See* Mason, *supra* note 3, at 985–87 (explaining that the federal government uses tax expenditures to regulate a range of activities); *c.f.* David M. Schizer, *Limiting Tax Expenditures*, 68 TAX L. REV. 275, 275 (2015) (noting that the federal government reserves trillions of dollars for goals other than raising revenue). For example, in 2020, the government set aside about $214.4 billion to subsidize taxpayers purchasing medical insurance through an employer; $83.5 billion for those contributing to a 401(k), and $75.7 billion for those raising children. TAX EXPENDITURES, *supra* note 4, at tbl.1. Congress also regulates behavior using tax penalties, but does so to a lesser degree. Mason, *supra* note 3, at 981. Companies cannot, for instance, deduct the fines they incur. *Id.*; *see also* I.R.C. § 162(f) (providing that certain fines and penalties are not eligible for deductions). The United States Department of Treasury ("Treasury") heads the Internal Revenue Service (IRS or "Service") along with several other sub-agencies, including the Alcohol and Tobacco Tax and Trade Bureau, the Customs Service, and the United States Mint, and is responsible for "promoting economic prosperity and ensuring the soundness and security of the U.S. and international financial systems." *Treasury Department*, FED. REG., https://www.federalregister.gov/agencies/treasury-department [https://perma.cc/DD4X-P5QK] (describing Treasury's purpose and its various sub-agencies).

[9] *See* Heather M. Field, *Binding Choices: Tax Elections & Federal/State Conformity*, 32 VA. TAX REV. 527, 540–41 (2013) (explaining that changes in federal tax law result in loss in state revenue even without action from state legislatures in states with rolling conformity to the most recent version of the Internal Revenue Code (IRC or "Code")); Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267, 1289–94, 1303 (2013) (describing the impact of federal tax expenditures on state tax revenue).

[10] *See* Mason, *supra* note 9, at 1269 (noting that the amount of state revenue from income tax mirrors changes to the federal tax base); Surrey, *supra* note 3, at 711 (explaining that Congress reduces the tax base when passing tax expenditures).

[11] Mason, *supra* note 3, at 985. One example of this "stealth preemption" has Congress exerting ever greater control over non-profit entities through its ability to grant federal tax-exempt status. *See id.* (discussing Professor James Fishman's argument that the federal government is intruding on state regulation of charities); *see also* James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX. REV. 545, 558 (2010) (explaining that the tax-exempt rules for non-profits contained in section 501(c)(3) of the Code mandate corporate governance practices). For example, the IRS questions applicants on topics like their compensation practices and processes to identify conflicts of interests. Fishman, *supra*, at 560. Arguably, such demands intrude on a traditional area of state interest over which states are in a better position to exert regulatory control. *Id.* at 586.

[12] *See* Field, *supra* note 9, at 541–42 (discussing how states sacrifice sovereignty when conforming to federal tax law); Mason, *supra* note 9, at 1293 (noting that by adopting federal tax law, states subsidize the activities Congress chooses to subsidize). For example, consider the federal mortgage interest deduction. *See* Mason, *supra* note 9, at 1303 (using the federal mortgage interest deduction to

This Note argues that federal place-based investment tax incentives deserve special scrutiny before state-level adoption.[13] Even though Congress intends these incentives to improve economic conditions at the community level, their provisions apply uniformly without regard to the mix of contributors to poverty and unemployment that vary by region and state.[14] The first federal tax expenditure of this kind came in the form of the LIHTC in 1986, whereby investors received a tax credit so long as they invested in low-income housing construction in high-poverty areas.[15] Subsequent provisions expanded the use of federal place-based investment tax incentives and imposed fewer restrictions on the types of projects eligible for investment.[16] The impetus driving the federal government to enact this type of tax incentive is the belief that market-based initiatives are better at spurring community development than direct government interventions.[17] Investors receive the tax breaks, but the economic benefits trickle down to community residents by providing more employment opportunities, higher wages, and a better quality of life.[18] The evidence, however, is decidedly mixed.[19] Because the Internal Revenue Service (IRS or Service) does little in the way of collecting data on tax expendi-

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illustrate the impact of federal tax expenditures on a state's ability to adjust tax incentives to better fit local needs). Coastal states have a tighter housing market than states in the Midwest. *Id.* Taxpayers across the United States, however, qualify for the same federal mortgage interest rate deduction no matter where they buy a home. *Id.* If their state follows federal income tax calculations, they will receive a similar reduction to their state tax bill. *See id.* at 1269 (explaining the effect of state conformity with federal tax law). Sacrificing state tax revenue to subsidize homeownership may, for instance, make more sense in Montana, the least densely populated state with an income tax, than in California where housing demand far outstrips supply. *See* FED'N OF TAX ADM'RS, STATE PERSONAL INCOME TAXES: FEDERAL STARTING POINTS 1 (2020) (providing tax regime by state with Alaska and Wyoming as states with no income tax); LEGIS. ANALYST'S OFF. OF THE CAL. LEGISLATURE'S NONPARTISAN FISCAL & POL'Y ADVISOR, CALIFORNIA'S HIGH HOUSING COSTS 10 (2015) (explaining that the high demand relative to supply of housing in California is the cause of high home prices); U.S. DEP'T OF COM. ET AL., UNITED STATES SUMMARY: 2010, POPULATION AND HOUSING COUNTS 41 (2012) (listing Montana behind Alaska and Wyoming as the least densely populated state.

[13] *See infra* notes 102–150 and accompanying text (providing a critical assessment of federal place-based investment tax incentives).

[14] *See* Mason, *supra* note 9, at 1303 (arguing that conformity decreases states' ability to adjust incentives to account for regional differences); *infra* notes 206–214 and accompanying text (arguing that states should evaluate federal place-based tax policies before deciding to enact the provisions in the state tax code).

[15] I.R.C. § 42; *see* Orfield, *supra* note 5, at 131 (discussing the impetus for Congress to pass the LIHTC program).

[16] *See* I.R.C. §§ 45D, 1400Z-1 to -2 (providing no limitations on the types of projects eligible for the New Markets Tax Credit (NMTC) program or for Opportunity Zone tax incentives contained in the 2017 Tax Cuts and Jobs Act (TCJA)).

[17] Michelle D. Layser, *The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform*, 2019 WIS. L. REV. 745, 778.

[18] *Id.*

[19] David Neumark & Helen Simpson, *Place-Based Policies*, *in* 5B HANDBOOK ON REGIONAL AND URBAN ECONOMICS 1197, 1279 (2015).

ture schemes, we do not know the true effects of interventions of this kind.[20] Where the information exists, an uneven track record emerges.[21] Whether these tax breaks improve the economic well-being of residents in targeted communities is uncertain.[22] Critics have also accused these incentives of exacerbating social ills like racial segregation and gentrification.[23]

Yet, Congress continues to renew old and enact new place-based investment tax incentives.[24] The 2017 Tax Cuts and Jobs Act (TCJA), for example, includes a new provision permitting individuals to avoid paying taxes on profits from the sale of capital assets when invested in low-income areas known as "Opportunity Zones."[25] With an estimated cost of $1.6 billion to the federal government over a decade, the program's ultimate budgetary impact remains largely unknown.[26] As a result, whether the expenditure will exact a high price from state budgets is murky, as is whether the incentive will yield better results than past place-based tax initiatives.[27]

The question thus becomes how state legislatures should respond when Congress passes new place-based investment tax expenditures.[28] One approach would be to simply stop importing federal calculations of taxable income.[29] Doing so, however, would mean that states would not be able to leverage the

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[20] STEUERLE, *supra* note 1, at 198, 206.

[21] *See infra* notes 106–125 and accompanying text (assessing outcomes from federal place-based investment tax incentives).

[22] *See, e.g.*, Richard C. Hula & Marty P. Jordan, *Private Investment and Public Redevelopment: The Case of New Markets Tax Credits*, 10 POVERTY & PUB. POL'Y 11, 26 (2018) (noting that studies have not shown that the NMTC substantially enhances the lives of residents in targeted communities).

[23] *See, e.g.*, Michelle D. Layser, *How Federal Tax Law Rewards Housing Segregation*, 98 IND. L.J. 915, 948–49 (2018) (arguing that the design of the LIHTC exacerbated the segregation of low-income communities).

[24] *See* I.R.C. § 1400Z-1 to -2 (providing for a place-based tax incentive passed in 2017).

[25] *Id.*

[26] *See* JOINT COMM. ON TAX'N, JCX-67-17, ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" 6 (Comm. Print 2017) [hereinafter JCX-67-17] (estimating the cost of creating Opportunity Zones); *see also* SCOTT EASTMAN & NICOLE KAEDING, OPPORTUNITY ZONES: WHAT WE KNOW AND WHAT WE DON'T 7 (2019) (asserting that because, on the one hand government projections extend only to 2027, and on the other hand Treasury regulations phase out benefits more than two decades later, it is impossible to know the program's final budgetary impact).

[27] *See* Mason, *supra* note 9, at 1289 (describing the effect of federal tax expenditures on state budgets); Neumark & Simpson, *supra* note 19, at 1279 (arguing that the outcomes from place-based tax policies present ambiguous results).

[28] *See* Mason, *supra* note 9, at 1270–71 (arguing that the impact of federal-state tax base conformity deserves closer assessment). Generally, federal-state tax base conformity is an issue of concern because first, proceeds from income tax make up an increasingly higher proportion of a state's tax base; second, Congress has shown expanding preference to regulate behaviors using the federal tax-code; and third, the growing bi-partisan divide will likely mean that states policy goals will increasingly diverge from national policy choices. *Id.*

[29] *Id.* at 1278. States have sovereign power to define their tax base and can choose to abandon federal definitions of income at will. 71 AM. JUR. 2D *State & Local Taxation* § 56, Westlaw (database updated Feb. 2021); Mason, *supra* note 9, at 1271.

Service's extensive rulemaking expertise and enforcement capabilities.[30] Decoupling from the federal tax base would also make filing taxes more onerous for taxpayers.[31]

This Note advocates for an alternative approach—one that retains conformity with federal definitions of income but evaluates these provisions for fit when importing them into the state tax code.[32] It proposes a framework for states to assess whether federal place-based investment tax incentives are compatible with state objectives.[33] Factors considered in the framework fall into three categories.[34] The first examines the structure of the provision itself and asks whether its design allows states to measure its performance.[35] The second considers the types of structural processes necessary to conduct ongoing monitoring and evaluation of the intervention's outcomes.[36] The third examines whether the incentive aligns with principles of sound tax policy such that it nets an overall benefit to society, while distributing those benefits equitably.[37]

Part I of this Note provides a primer on federal place-based investment tax incentives enacted to date and outlines their key critiques.[38] Part II describes how federally-enacted place-based policies impact states.[39] Part III concludes by offering a framework to assist state legislatures in deciding whether to import such provisions into their tax codes.[40]

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[30] Mason, *supra* note 9, at 1280. For example, when states conform to federal definitions of income, they can exchange information with the federal government to ensure taxpayers have paid their share in taxes. *Id.* at 1280–81.

[31] *Id.*

[32] *See infra* notes 206–214 and accompanying text (arguing that states can retain the benefits of conformity while evaluating whether federal place-based investment tax incentives are a good fit for their communities).

[33] *See infra* notes 221–264 and accompanying text (proposing three categories of factors states should consider when confronted with new federal place-based investment tax incentives).

[34] *See infra* notes 221–264 and accompanying text (same).

[35] *See infra* notes 221–235 and accompanying text (describing an approach to evaluate the features of a federal place-based investment tax incentive).

[36] *See infra* notes 236–253 and accompanying text (discussing state-specific factors when considering compatibility of a federal place-based investment tax incentive).

[37] *See infra* notes 254–264 and accompanying text (considering tax policy principles of efficiency and equity as applied to place-based investment tax incentives).

[38] *See infra* notes 41–150 and accompanying text (describing the LIHTC, the NMTC, and the Opportunity Zone tax incentives and their effects on racial segregation, gentrification, as well as their uneven economic track record).

[39] *See infra* notes 151–205 and accompanying text (explaining the concept of tax expenditures and federal and state tax base conformity).

[40] *See infra* notes 206–264 and accompanying text (discussing fixed and dynamic conformity with federal tax law and proposing a framework to evaluate newly enacted federal place-based investment tax incentives).

I. FEDERAL TAX EXPENDITURES AS A COMMUNITY DEVELOPMENT TOOL

Governments have a variety of ways to selectively tax income to regulate conduct.[41] Congress can provide taxpayers with exclusions, deferrals, deductions, and tax credits—all of which reduce the amount of taxes collected.[42] These policy levers are known as tax expenditures, and they use economic incentives to encourage what Congress believes are behaviors and activities beneficial to national welfare.[43] Starting from the mid-1980s—drawn to the prom-

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[41] *See* ROBERT S. SMITH & ADELE T. SMITH, WEST'S TAX LAW DICTIONARY § T615 (2019) (defining tax incentive). Earnings earned from labor and capital is income, but not all income is taxable. *Id.* § I320.

[42] *See* Surrey, *supra* note 3, at 706–07, 711–12 (defining tax expenditures and their goals). Computing income tax liability begins with the taxpayer's gross income, defined in the Code as all income irrespective of its source. I.R.C. § 61(a). Gross income includes, for example, wages, business income, gains from the sale of property, dividends, interest, and capital gains. *Id.* An exclusion allows for certain items of "income" otherwise within the meaning of the Code to be omitted from the definition of gross income. *See id.* § 61(b) (cross-referencing to items specifically excluded from gross income). From gross income, taxpayers subtract certain "above-the-line" deductions to arrive at federal Adjusted Gross Income (AGI), and then, "below-the-line" deductions to calculate their federal "taxable income." *Id.* §§ 62–63; 33 AM. JUR. 2D *Federal Taxation* ¶ 1001, Westlaw (database updated Feb. 2021). Several of these deductions are meant to avoid taxing income with value partly derived from dollars previously taxed, otherwise known as double taxation. *See* Theodore P. Seto & Sande L. Buhai, *Tax and Disability: Ability to Pay and the Taxation of Difference*, 154 U. PA. L. REV. 1053, 1077 (2006) (explaining comprehensive tax base theory); *see, e.g.*, I.R.C. §§ 162, 167 (allowing deductions for trade or business expenses and depreciation of property used in a trade or business or for the production of income). Other deductions aim to calibrate tax liability more closely to a taxpayer's ability to pay. *See* Joel S. Newman, *Of Taxes and Other Casualties*, 34 HASTINGS L.J. 941, 943 (1983) (noting that, despite its conceptual flaws, gauging the "ability to pay" forms the theoretical foundation of our tax regime); *see, e.g.*, I.R.C. §§ 165, 213 (providing for deductions for casualty losses and unreimbursed medical expenses); JOINT COMM. ON TAX'N, JCS-10-87, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 50–51 (Comm. Print 1987) (explaining that the Tax Reform Act of 1986 raises the medical expense deduction floor to 7.5% of a taxpayer's AGI such that it provides relief only when the expense is so great as to affect a taxpayer's ability to pay their income tax). To arrive closer to their total tax liability, taxpayers must multiply their taxable income by their applicable tax rate, and that rate depends on the taxpayer's status, as well as the type and amount of income. I.R.C. § 1; *see* 33 *Federal Taxation*, *supra*, ¶ 1004 (providing tax rates for calculating tax liability). Special tax rates apply to capital gains, income from farming, individuals with short tax years, and income of certain children. *Federal Taxation*, *supra*, ¶ 1001. Finally, taxpayers can reduce their total taxes due by subtracting qualifying tax credits. SMITH & SMITH, *supra* note 41, § T330.

[43] Surrey, *supra* note 3, at 711. Certain deductions incentivize charitable giving and homeownership. *See* I.R.C. §§ 163(h), 170 (providing for deductions for mortgage interest payments and charitable giving, respectively). For example, gross income for employees excludes the premiums employers pay for health and accident insurance, disability insurance, and life insurance. *See id.* §§ 9, 104(a)(3), 105(a)–(b), 106 (provisions excluding employer-paid life, health, accident, and disability insurance). These exclusions effectively increase the value employees derive from their job without an accompanying increase in taxable income. *See* STEUERLE, *supra* note 1, at 40 (explaining the effects of exclusions from gross income and noting that exclusions accounted for 15% of personal income in 2000). They encourage employers to offer benefits arguably constituting a sort of private-sector social safety net. *See* William P. Kratzke, *The (Im)balance of Externalities in Employment-based Exclusions from Gross Income*, 60 TAX LAW. 1, 1 (2006) (arguing that such exclusions shape the employment relationship and generate inefficiencies that outweigh the public policy benefits). To illustrate a deferral,

ise of a market-driven solution to deliver benefits to low-income communities requiring minimal government intervention—the federal government turned to tax expenditures as a solution to endemic poverty.[44] Section A of this Part provides a history of federal place-based investment tax incentives Congress has passed to date.[45] Section B assesses the impact of such interventions on low-income communities.[46]

A. History of Federal Place-based Investment Tax Incentives

Investment tax incentives are a kind of tax expenditure designed to influence taxpayer decisions on how to allocate funds, alongside the expectation of achieving a profit.[47] Provisions in the tax code are place-based when geography determines how those provisions apply to taxpayers.[48] Place-based investment tax incentives subsidize the cost of investment activity in specific

consider interest income from qualified retirement and education savings accounts. *See* I.R.C. § 401 (providing for qualified pension, profit-sharing, and stock bonus plans); *id.* § 529 (providing for qualified tuition programs). Here, taxpayers only pay taxes when they withdraw funds from accounts instead of the year when the interest accrued. BORIS BITTKER ET AL., FEDERAL INCOME TAXATION OF INDIVIDUALS 40-38, 40-44 (3d ed. 2002). In this case, taxpayers defer recognition of income, meaning taxpayers may have earned income during one taxable period but do not report the income on their tax return until some point later in time. *Id.* at 28-4. Taxpayers may *realize* income, but the I.R.S. decides when to *recognize* the income as taxable. *Id.* at 28-5. Although they will eventually owe taxes, they derive additional tax-free interest income so long as their money remains in qualified savings accounts. *Id.* In addition, deferring the payment of a tax liability reduces the amount owed because of the time value of money. BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 28.1 (West 2021). The time value of money posits that cash in hand has more value than the same amount of cash if an individual received it at a later time, because that person can invest cash in hand and earn interest in the interim. *Time Value of Money*, OXFORD DICTIONARY OF FINANCE & BANKING (6th ed. 2018). By the same token, money the person pays at a later date has less value than the same amount of money if the person pays it now. *Id.* All of these benefits should motivate economically rational taxpayers to save money for retirement or for education. STEUERLE, *supra* note 1, at 62; *see, e.g.*, I.R.C. § 219 (providing deductions for qualified retirement contributions). Individuals can engage in further tax arbitrage by borrowing interest-deductible mortgage loans and direct cash flow to savings vehicles whose interest income is exempt from taxation. STEUERLE, *supra* note 1, at 62.

[44] *See* Layser, *supra* note 17, at 778 (discussing the origins of federal place-based tax incentives).

[45] *See infra* notes 47–101 and accompanying text (considering the implications of state conformity with federal tax law).

[46] *See infra* notes 102–150 and accompanying text (examining the design of federal place-based investment tax incentives Congress has enacted to date).

[47] *See* Surrey, *supra* note 3, at 711 (explaining the objectives of investment tax incentives).

[48] Daniel J. Hemel, *A Place for Place in Federal Tax Law*, 45 OHIO N.U. L. REV. 525, 526 (2019) (defining place-based rules as those that result in different tax burdens based on a taxpayer's place of residency, location of property, or locus of activity). Federal tax law rarely provides tax breaks based solely on whether a taxpayer carries out an activity in a particular place. *See id.* at 527 (finding spatial distinctions in federal U.S. taxation to be rare). Prominent examples include a variety of tax rules applying solely to U.S. taxpayers living abroad, as well as Code provisions exempting residents of unincorporated U.S. territories, such as Puerto Rico and the U.S. Virgin Islands, from taxation on personal income earned within those territories. *Id.* at 528.

locations, mainly high-poverty areas or regions where the area median income is low relative to the cost of construction, land, and utilities.[49] First proposed in the United States in the late 1970s, these incentives operated under the assumption that governments could target distressed neighborhoods for economic development by extending tax benefits to businesses willing to relocate to those areas.[50] Original proponents of place-based investment tax incentives theorized that urban decline inevitably resulted from people and businesses abandoning cities for the suburbs.[51] To tackle the problem, policymakers since the 1980s have focused on private development and local entrepreneurship as an anti-poverty solution.[52] In particular, three of the four federal place-based

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[49] *See, e.g.*, I.R.C. § 42(d)(5)(B) (defining qualified census tracts and difficult development areas eligible for LIHTC).

[50] Jeffrey M. Euston, *Clinton's Empowerment Zones: Hope for the Cities or a Failing Enterprise?*, 3 KAN. J.L. & PUB. POL'Y 140, 141 (1994) (discussing the development of enterprise zones). Such initiatives initially took the form of enterprise zones. Layser, *supra* note 17, at 778. A British academic, University of Reading Professor Peter Hall, first conceived of tax incentives as part of an overall package to revive, what he called, "enterprise zones." Euston, *supra*, at 141. Use of enterprise zones as a policy tool gained a foothold in the English-speaking world in 1980 when newly-elected prime minister, Margaret Thatcher, enacted legislation that sought to jump-start activity in industrial centers, rather than revive distressed urban areas. *Id.* In the United States, the concept found a receptive audience in a political landscape dominated by neoliberal ideology. *See* TIMOTHY P.R. WEAVER, BLAZING THE NEOLIBERAL TRAIL: URBAN POLITICAL DEVELOPMENT IN THE UNITED STATES AND THE UNITED KINGDOM 29 (2016) (tracing the evolution of neoliberal ideology in urban development policies); Layser, *supra* note 17, at 778 (arguing that Reagan-era efforts to weaken the regulatory state included not only cuts to federal spending, but the promotion of policies that allowed for minimal government intervention). Neoliberalists believe broadly that a freer and richer society results from a socio-economic system prioritizing the interests of financial capital and promoting property rights, open markets, and free trade. WEAVER, *supra*, at 11. Neoliberals rejected Keynesian interventions of the post-war New Deal era and instead advocated for tax cuts, privatization of public services, reductions in redistributive welfare, and anti-union policies. *Id.*

[51] *See* WEAVER, *supra* note 50, at 35–36 (discussing the diagnosis posited by Stuart Butler, a policy analyst credited for seeding the idea of enterprise zones in the United States in a report published in 1979 under the aegis of the Heritage Foundation). The hypothesis is that such losses deliver a one-two punch to city finances: a shrinking tax base and increased costs to maintain and police abandoned areas. STUART M. BUTLER, ENTERPRISE ZONES: GREENLINING THE INNER CITIES 45 (1981).

[52] Michelle D. Layser, *A Typology of Place-Based Investment Tax Incentives*, 25 WASH. & LEE J. C.R. & SOC. JUST. 403, 405 (2019); *see also Tax Incentives Targeted to Distressed Areas: Hearing Before the H. Comm. on Ways & Means*, 98th Cong. 33 (1983) (statement of Congressman E. de la Garza from Texas noting the importance of access to capital for small businesses) [hereinafter *Hearing*]; Stuart M. Butler, *'Supply Side' in the Inner City Enterprise Zones in America*, 7 BUILT ENV'T 42, 46 (1981) (noting that access to capital was often the major obstacle for small firms). When first proposed and packaged as a key feature in enterprise zone programs, place-based investment tax incentives were not urban renewal initiatives. Peter Hall, *Enterprise Zones: British Origins, American Adaptations*, 7 BUILT ENV'T 4, 6 (1981). As originally intended, enterprise zones would occupy rundown areas with few, if any, inhabitants, effectively creating industrial parks outside residential areas. Euston, *supra* note 50, at 141; Hall, *supra*, at 6. Even as the goal for place-based incentives shifted from industrial development to community revitalization, policymakers continued to stress the role of small business entrepreneurship, as well as real estate development to address affordable housing needs. *See, e.g.*, *Hearing*, *supra*, at 40 (statement of Congressman Jack E. Kemp claiming that enterprise zone tax incentives were uniquely placed to target small businesses most likely to provide jobs

investment tax incentives enacted to date exhibit a preference for taxpayers willing to invest in projects and businesses operating in distressed areas.[53] Contrast these indirect subsidies with the tax incentives the federal government provides directly to business owners located in state "enterprise zones" or federally-enacted "empowerment zones."[54] Indirect investment tax incentives, instead, subsidize taxpayers who invest capital in local businesses.[55] This Note focuses on this type of place-based policy because, for the past two decades, Congress has favored indirect investment tax incentives to pursue its community development goals.[56]

Supporters of indirect investment tax incentives believe that investors are generally less willing to provide capital to projects located in low-income communities because they expect higher risk and a lower rate of return.[57] Without adequate equity investment, institutional lenders are, in turn, less willing to provide loans to these businesses.[58] Therefore, by subsidizing the cost of providing capital to local businesses, preferential tax treatment for investors increases the likelihood that local businesses can attract sufficient working capital.[59] Indeed, during the early stages of growth, providing tax benefits di-

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in low-income areas). Fostering local start-ups was thought to create, rather than merely geographically reallocate, jobs and economic prosperity—a common critique of early enterprise zone initiatives in Britain. *See, e.g.*, Butler, *supra*, at 44; Hall, *supra*, at 7. This argument is an extension of empirical studies showing that, at the time, small businesses created nearly two-thirds of net new jobs in America. David Boeck, *The Enterprise Zone Debate*, 16 URB. LAW. 71, 78 (1984); *see* David L. Birch, *Who Creates Jobs?*, 65 PUB. INT. 1, 7 (1981) (showing that, at the time, more than two-thirds of new jobs created in the United States originated from businesses with twenty or fewer employees).

53 *See* Layser, *supra* note 52, at 443, 447 n.208 (comparing the characteristics of the following federal place-based investment tax incentives: the LIHTC, Empowerment Zone laws, the NMTC, and the TCJA 2017 Opportunity Zone initiative).

54 *Compare* I.R.C. §§ 1396, 1397C (providing tax credits to employers within qualified "empowerment zones" equal to 20% of employee wages), *and* COLO. REV. STAT. § 39-30-105.1 (2020) (providing $1,100 of tax credits per year for each employee to employers who operates in a state enterprise zone), *with* I.R.C. §§ 1400Z-1 to -2 (providing deferrals and reductions in taxes owed on capital gains if those capital gains are invested in Opportunity Zones).

55 Layser, *supra* note 52, at 417–18. Tax expenditure theory posits that when the tax code provides preferential treatment for certain activities, the government is using tax dollars to subsidize taxpayers much as if it had cut them a check directly. *Id.* at 412–14; *see also* Surrey, *supra* note 3, at 715 (rejecting assertions that tax incentives are not government subsidies).

56 *See* Layser, *supra* note 52, at 447–52 (categorizing the LIHTC, NMTC, and Opportunity Zone program contained in the TCJA as indirect investment tax incentives); *see infra* notes 62–101 and accompanying text (discussing the LIHTC, NMTC, and Opportunity Zone programs).

57 Layser, *supra* note 52, at 419 & n.69. Early proposals contained the complete elimination of the capital gains tax on investments within targeted zones and a 50% deduction for income and interest on such investments. *See* Butler, *supra* note 52, at 47 (describing investment tax incentives contained in the first bill introduced to Congress proposing enterprise zones).

58 Layser, *supra* note 52, at 417 & n.69.

59 *Id.* at 417; *see* Michael Livingston, *Risky Business: Economics, Culture, and the Taxation of High-Risk Activities*, 48 TAX L. REV. 163, 168 (1993) (noting one view of the relationship between taxation and investment risk-taking). Some lawmakers consider investment tax incentives to be more crucial than tax credits or reduced marginal rates. *See, e.g.*, *Hearing*, *supra* note 52, at 3 (containing a

rectly to local business owners and project developers does little to decrease barriers to entry because these entities often have little income to offset.[60]

This Section examines the three place-based investment tax incentives enacted at the federal level from 1986 to the present day; Subsection One discusses the LIHTC, Subsection Two describes the New Markets Tax Credit (NMTC), and Subsection Three examines the Opportunity Zone program passed with the TCJA.[61]

1. The Low-Income Housing Tax Credit of 1986

Congress first inserted an indirect place-based investment tax incentive into the Internal Revenue Code (IRC or Code) in 1986 as a response to an increased demand for affordable housing.[62] Known as the LIHTC, the provision allows residential property developers to claim tax credits over ten years, covering up to 70% of the costs to construct or renovate low-income housing units.[63] This amount can reach 91% in high-poverty census tracts or areas where there are high construction, land, and utility costs relative to median income.[64] Projects qualify for credits only if developers set aside a fixed percentage of units for

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statement of Congressman E. de la Garza from Texas supporting a proposal that would allow expensing enterprise zone investments). These ideas are consistent with supply-side economic theory, dominant in the 1980s when Congress first proposed such incentives. *See* Butler, *supra* note 52, at 46 (describing the first lawmakers promoting tax relief for capital investments in enterprise zones as "supply-side" Republicans); Layser, *supra* note 17, at 778 (noting the receptive political environment in which place-based investment tax incentives first took root); *see also* Arthur B. Laffer, *Supply-Side Economics*, 37 FIN. ANALYSTS J. 29, 29 (1981) (arguing that tax cuts on capital lead to more investment, resulting in lower unemployment and higher wages).

[60] Layser, *supra* note 52, at 417; *see also* Butler, *supra* note 52, at 46 (noting that small businesses rarely consider income tax to be the major obstacle preventing them from launching or expanding operations). This Note does not discuss direct place-based investment tax incentives in detail, but they include most enterprise zone initiatives, like the one contained in the Economic Empowerment Act of 1993. *See* Euston, *supra* note 50, at 145–46 (describing key initiatives in the Economic Empowerment Act of 1993). Businesses operating within designated areas could deduct up to $37,500 in investments in depreciable property during the first year. *Id.* By contrast, federal tax law, at the time, allowed businesses to write off only $10,000. *Id.* Those that hired zone residents additionally qualified for up to $3,000 in credits for the first $15,000 in payroll expenses. *Id.*

[61] *See infra* notes 62–101 and accompanying text (examining the LIHTC and the NMTC programs, as well as the Opportunity Zone scheme passed in the TCJA).

[62] Orfield, *supra* note 5, at 131 (explaining the history of the LIHTC). Prior to the LIHTC, the Department of Housing and Urban Development (HUD) and the Department of Agriculture administered almost all federal housing subsidies at the time the Fair Housing Act (FHA) was passed in 1968. *Id.* at 130. A growing demand for affordable housing and a series of missteps involving HUD, however, prompted the federal government to find a mechanism to replace direct subsidies for the construction of low-income housing. *Id.* The LIHTC filled this void. *Id.* at 131.

[63] I.R.C. § 42. A tax credit allows taxpayers to, after determining their total tax liability, subtract the credit amount from the total sum of taxes they owe. *Tax Credit*, BLACK'S LAW DICTIONARY (11th ed. 2019).

[64] I.R.C. § 42; Hemel, *supra* note 48, at 528–29 (explaining how Treasury calculates credit allocations under LIHTC provisions).

low-income households for at least fifteen years.[65] These units are also subject to a rent ceiling capped at 30% of the household's income.[66]

The LIHTC program remains the largest federal initiative supporting the construction of low-income housing.[67] Treasury tasks states with allocating its annual quota of federal tax credits to private developers.[68] States have generally funneled a large portion of their credits to developers operating in areas with sizable minority and low-income populations.[69] Because the tax credits often do not cover the entire cost of construction, developers require additional funding.[70] So, they effectively sell the credits to third parties in return for equity investment.[71] These investors contribute equity at the start of the project and receive the right to claim tax credits throughout the qualifying ten-year period.[72] Through this process of tax credit monetization, developers can access the full value of credits at the onset when a project requires the most capital investment even though Treasury allocates the tax credits from the LIHTC program over a decade.[73]

2. The New Markets Tax Credit of 2000

In 2000, the Clinton administration signed into law the NMTC program as part of the Community Renewal Tax Relief Act.[74] The Community Devel-

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[65] I.R.C. § 42(g). Twenty percent of units must be available to households with income at or below 50% of the area's median gross income, or alternatively, 40% of units must be available to households with income at or below 60% of the area's median gross income. *Id.* § 42(g)(1)(C)(i)–(ii). Developers can also choose to set aside 40% of units to households with income levels at 20%, 30%, 40%, 50%, 60%, or 80% of the area's median gross income, so long as *average* income is at or below 60% of the area's median gross income. *Id.* § 42(g)(1)(C)(ii)(III).

[66] *Id.* § 42(g)(2). For example, if a unit is destined for a household with income at or below 60% of area median income, then rent is capped 18% of area median income because it cannot exceed 30% of the income limitation applicable to that unit. *See id.* (providing for limitations on rent charged for designated low-income units); Michael D. Eriksen & Stuart S. Rosenthal, *Crowd Out Effects of Place-Based Subsidized Rental Housing: New Evidence from the LIHTC Program*, 94 J. PUB. ECON. 953, 954 & n.8 (2010) (calculating rent caps as related to area median income).

[67] Orfield, *supra* note 5, at 103.

[68] I.R.C. § 42(h)(3)(C), (m). The federal government requires states to devise Qualified Allocation Plans that lay out the methodologies by which they select and award the credits. Brandon M. Weiss, *Locating Affordable Housing: The Legal System's Misallocation of Subsidized Housing Incentives*, 70 HASTINGS L.J. 215, 221 (2019).

[69] Orfield, *supra* note 5, at 103.

[70] Layser, *supra* note 52, at 420.

[71] *Id.*

[72] *Id.* at 423.

[73] *Id.*

[74] Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, app. G, § 1, 114 Stat. 2763A–587; *see* I.R.C. § 45D (providing for the NMTC); Hemel, *supra* note 48, at 530 (explaining the history of the NMTC). The NMTC was set to expire in 2019, but instead, Congress extended the program for another year at a $5 billion cost through 2020, as part of a spending package President Donald J. Trump signed into law on December 20, 2019. H.R. 1865, 116th Cong. (2019) (enacted as Further Consolidated Appropriations Act of 2020, Pub. L. No. 116-94, 133 Stat. 2534).

opment Financial Institutions (CDFI) Fund, a division of the Treasury, administers the program and provides tax credits to Treasury-certified investment groups, known as Community Development Entities (CDE).[75] CDEs are for-profit corporations or partnerships that offer tax credits to third-party taxpayers in exchange for capital investments.[76] CDEs then invest the capital in low-income communities in the form of loans or equity investments.[77] Communities eligible for these capital infusions must have a poverty rate of at least 20% or a median family income not exceeding 80% of the greater of either the statewide or the metropolitan median family income.[78]

The NMTC incentive structure intends to hold CDEs accountable in two ways: first, via its governance structure, by allocating board seats to community members, and second, through an annual process in which CDEs must apply to Treasury and compete for a finite allocation of tax credits.[79] States can free-ride the federal CDE certification process and allocate tax credits offsetting state tax liabilities for investments in CDEs operating locally.[80] Contrary to the LIHTC program, however, the Treasury makes all federal allocation decisions and distributes tax credits directly to CDEs without input from states.[81] To

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[75] *See* Consolidated Appropriations Act of 2001, Pub. L. No. 106-554, app. D, 114 Stat. 2763 (amending title III of Public Law 106-377 to grant NMTC administration to Treasury's Community Development Financial Institutions (CDFI) Fund); Matthew Freedman, *Teaching New Markets Old Tricks: The Effects of Subsidized Investment on Low-Income Neighborhoods*, 96 J. PUB. POL'Y 1000, 1001 (2012) (describing the mechanisms by which the CDFI Fund distributes tax credits).

[76] I.R.C. § 45D(c)(1); *see* Layser, *supra* note 52, at 421–22 (describing the role of Community Development Entities (CDEs)). CDEs are typically financial institutions or affiliates of non-qualifying financial institutions. Laura Molloy, *New Markets Tax Credits: A Success at Federal and State Levels*, J. MULTISTATE TAX'N & INCENTIVES, Nov.–Dec. 2013, at 20, 22 (2013).

[77] Layser, *supra* note 52, at 421–22. In their early years, from 2002 through 2009, CDEs funneled over two-thirds of all investment dollars into commercial real estate projects. Freedman, *supra* note 75, at 1002. Only about half of a percent went to residential real estate. *Id.*

[78] I.R.C. § 45D(e)(1). A number of low-population census tracts failing to meet these criteria also qualify. Freedman, *supra* note 75, at 1002. These areas are in Empowerment Zones, adjacent to qualifying low-income communities, and have populations of less than two thousand people. *Id.* Treasury also allows CDEs to provide capital to businesses outside of these areas so long as those businesses serve the targeted population. *Id.* These populations include low-income Native American populations, as well as those who have difficulty accessing loans and capital investments. *Id.*

[79] Freedman, *supra* note 75, at 1001. The CDFI Fund is the administering entity and sits in Treasury's Office of Domestic Finance. *Financial Institutions*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/about/offices/domestic-finance/financial-institutions [https://perma.cc/3A2M-8SB8] (describing functions of the Office of Domestic Finance). Between 2003 and 2017, the CDFI Fund completed fifteen rounds of allocations, awarding a total of $57.5 billion in tax credits. CMTY. DEV. FIN. INSTS. FUND, NEW MARKETS TAX CREDIT (NMTC) PUBLIC DATA RELEASE: FY 2003 TO FY 2017 SUMMARY REPORT 1, 5 (2019), https://www.cdfifund.gov/sites/cdfi/files/documents/2019-nmtc-public-data-release_fy_17-comments-incorporated_bl-edits-incorporated_final.pdf [https://perma.cc/3BV3-TSAG].

[80] *See* Molloy, *supra* note 76, at 25 (describing state-level NMTC programs).

[81] Freedman, *supra* note 75, at 1001.

date, eight states have leveraged the NMTC program and provide additional state tax credits to investors in CDEs.[82]

3. The Opportunity Zone Program of 2017

As part of the TCJA, President Donald J. Trump in 2017 signed into law the latest iteration of place-based investment tax incentives, designed for qualified "Opportunity Zones."[83] Qualified Opportunity Zones are low-income communities, as defined under section 45D(e) of the Code, meaning population census tracts with either a poverty rate of at least 20%, or metropolitan areas where the median family income does not exceed 80% of the greater of the statewide or the metropolitan median family income.[84] State governors nominate, and Treasury designates, Opportunity Zones for each state.[85] The

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[82] *See* ALA. CODE § 41-9-219 (2020) (providing a tax credit in qualifying CDEs based on the federal NMTC program for investments); ARK. CODE ANN. §§ 15-4-3601 to -4-3614 (2020) (same); FLA. STAT. § 288.9916 (2020) (same); KY. REV. STAT. ANN. §§ 141.432–.434 (West 2020) (same); LA. STAT. ANN. § 47:6016.1 (2020) (same); ME. STAT. tit. 36, § 5219-HH (2019) (same); MISS. CODE ANN. § 57-105-1 (2020) (same); NEV. REV. STAT. § 231A.200 (2020) (same).

[83] I.R.C. § 1400Z-1; *see* Hemel, *supra* note 48, at 531 (describing Opportunity Zone provisions in the TCJA). The estimated cost of the Opportunity Zone program, at around $1.6 billion over a decade from 2018 to 2027, is low compared to past federal place-based investment tax incentives. Hemel, *supra* note 48, at 533, *see also* JCX-67-17, *supra* note 26, at 6 (projecting the budgetary impact of creating qualified Opportunity Zones). Because Treasury Regulations allow investors to benefit from the incentive until 2047, however, its revenue impact is largely unknown and will depend on the number of investors who participate in the program and the size of their holdings. *See* I.R.C. § 1400Z-2(c); Treas. Reg. § 1.1400Z2(c)-1(b) (2020) (allowing investors to exclude income from capital gains if they hold investments in qualified opportunity funds (QOFs) for at least ten years up to December 31, 2049); *see also* EASTMAN & KAEDING, *supra* note 26, at 7 (arguing that the revenue impact of Opportunity Zone incentives is largely unknown). By way of comparison, Congress allocated $5 billion for a one-year extension of the NMTC. H.R. 1865, 116th Cong. (2019) (enacted as Further Consolidated Appropriations Act of 2020, Pub. L. No. 116-94, 133 Stat. 2534). The LIHTC also costs $5 billion per year and receives matching funds from tax-exempt state and local bonds as well as donations to charitable organizations. Orfield, *supra* note 5, at 133 (discussing the cost of the LIHTC). The federal government ultimately spent approximately $2.5 billion on empowerment zones during the program's first decade. Hemel, *supra* note 48, at 530 (comparing the cost of the empowerment zone program with that of the LIHTC).

[84] I.R.C. §§ 45D(e)(1), 1400Z-1(a), 1400Z-1(c)(1). Certain low population tracts and rural counties also qualify. *See id.* § 45D(e)(4)–(5) (modifying the criteria for such areas). As of February 9, 2018, Congress also considers low-income communities in Puerto Rico to be certified Qualified Opportunity Zones (QOZ). *Id.* § 1400Z-1(b); *see also* I.R.S. Notice 2019-42, 2019-29 C.B. 352 (expanding I.R.S. Notice 2018-48, 2018-28 C.B. 9 to include Puerto Rico to list of QOZs); I.R.S. Notice 2018-48, 2018-28 C.B. 9 (listing the population census tracts the Secretary of Treasury designed as qualified Opportunity Zones).

[85] I.R.C. § 1400Z-1(b); Press Release, Treasury, IRS Announce Final Round of Opportunity Zone Designations, U.S. Dep't of the Treasury (June 14, 2018), https://home.treasury.gov/news/press-releases/sm0414 [https://perma.cc/9E45-BUT2]. Some areas that do not meet these conditions are nevertheless Opportunity Zones due to their proximity to low-income neighborhoods. I.R.C. § 1400Z-1(c). Treasury imposes few restrictions on the nomination process, meaning governors use a wide variety of methods in selecting and submitting zones for federal approval. Rebecca Lester et al., *Opportunity Zones: An Analysis of the Policy's Implications*, 90 STATE TAX NOTES 221, 223 (2018).

TCJA provides favorable tax treatment to taxpayers who invest in a "qualified opportunity fund" (QOF).[86] QOFs are investment vehicles in the United States, holding at least 90% of their assets in Opportunity Zone properties, and taxed federally as corporations or partnerships.[87]

Unlike previous place-based investment tax incentives, the TCJA does not offer a tax credit but instead modifies what counts as income in any taxable year.[88] Taxpayers receive preferential tax treatment on gains from the sale or exchange of capital assets when they reinvest those gains within 180 days in a QOF.[89] They can defer payment of any taxes due until they sell their holdings after the year 2047, thus decreasing the net present value of their tax liabilities.[90] Treasury provides an additional reduction of 10% or 15% to their final tax liabilities if they hold their investments for five or seven years, respectively.[91] If held for ten years, the taxpayers will owe no capital gains tax upon dis-

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Selection methods vary from pro rata allocation of qualifying counties to the use of predictive analysis to choose areas for their economic potential. *Id.*

[86] I.R.C. § 1400Z-2(d).

[87] *Id.* § 1400Z-2(d)(1). Opportunity Zone property includes stock or partnership interests in an Opportunity Zone business and certain tangible property used in the trade or business of a QOF or an Opportunity Zone business. *Id.* § 1400Z-2(d)(2); *see also* Treas. Reg. § 1.1400Z2(d) (providing requirements for tangible property); Rev. Rule 2018-29, 2018-45 I.R.B. 765 (providing requirements for "original use" and "substantial improvement" applicable to existing buildings and land purchased after 2017). A QOZ Business is any trade or business other than a "sin business," or one leasing more than a de minimis amount of property to a sin business. I.R.C. § 1400Z-2(d)(3)(A); Treas. Reg. § 1.1400Z2(d)-1(d)(4); *see also* I.R.C. § 1397C(b) (providing the definition of a qualified business entity). A sin business is "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." I.R.C. § 144(c)(6)(B). In addition, at least 70% of a QOZ business's tangible property is QOZ Property. I.R.C. § 1400Z-2(d)(3)(A)(i); Treas. Reg. § 1.1400Z2(d)-1(d)(2). Also, it must derive at least 50% of its gross income for each taxable year from trade or business in a QOZ. I.R.C. § 1400Z-2(d)(3)(A)(ii); *see also* Treas. Reg. § 1.1400Z2(d)-(1)(d)(1), -(1)(d)(3) (setting out further requirements under this provision). Further, it must use at least 40% of its intangible property in trade or business in the QOZ. I.R.C. § 1400Z-2(d)(3)(A)(ii); Treas. Reg. § 1.1400Z2(d)-1(d)(3)(ii). Lastly, less than 5% of the average aggregate unadjusted bases of a QOZ Business's property can be nonqualified financial property, subject to a working capital safe harbor. I.R.C. § 1400Z-2(d)(3)(A)(ii); Treas. Reg. § 1.1400Z2(d)-1(d)(3)(ii).

[88] *See* I.R.C. § 1400Z-2(b) (providing for deferral of gains invested in Opportunity Zone property).

[89] *Id.* § 1400Z-2(a)–(c). Without the provision, the IRS would include the gain on sale or exchange in gross income and levy taxes at a rate as high as 20%. *Id.* § 1(h).

[90] *Id.* § 1400Z-2(a)–(b)(1); *see also* Lester et al., *supra* note 85, at 224 (discussing how the Opportunity Zone provision treats capital gains reinvested in QOFs). Specifically, the Code provides for a temporary deferral of income until the date of divestment, another gain inclusion event, or December 31, 2026. *Id.* § 1400Z-2(a)–(b)(1); *see also* Treas. Reg. § 1.1400Z2(b)-1 (providing a non-exhaustive list of gain inclusion events).

[91] I.R.C. § 1400Z-2(b)(2)(B). QOF investments benefit from a step-up in basis equal to 10% of the deferred gain if held for five years and another 5% if held for an additional two years, up to December 31, 2026. *Id.* § 1400Z-2(b)(2). Basis is a number used to calculate the amount of taxable gain. SMITH & SMITH, *supra* note 41, § B260 (defining basis); *see also* I.R.C. §§ 1012, 1016 (providing for

position of their holdings.[92] The IRS does not cap the amount of capital gain invested or excluded, and taxpayers can self-certify their eligibility for the incentive.[93] Several states offer additional state and local tax incentives to Opportunity Zone investors.[94]

The Opportunity Zone program differs from the LIHTC and NMTC in three significant ways.[95] First, whereas only investments in affordable housing qualify for LIHTCs, and the NMTC program requires that qualified low-income community investments make up the majority of a CDE's investment portfolio, QOFs have few restrictions on eligible investments.[96] QOFs can, for example, invest in residential or commercial property or in projects as diverse as start-up incubators or large infrastructure projects.[97] Second, while CDEs must undergo a certification process to qualify for credits under NMTC provisions, QOFs self-certify.[98] Third, funding for the LIHTC and the NMTC is subject to budgetary constraints.[99] As a result, Treasury granted only a small percentage of applications from CDEs, approximately sixteen percent between 2003 and 2017.[100] There is no analogous limit on funding for the Opportunity Zone program.[101]

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calculations of basis). Generally, the higher an asset's basis, the less the taxpayer would owe in taxes upon sale of the asset. *See* I.R.C. § 1001 (providing for the calculation determining how much the gain or loss the federal tax system recognizes upon disposition of property).

[92] I.R.C. § 1400Z-2(c); Treas. Reg. § 1.1400Z2(c)-1(b).

[93] *See* I.R.C. §§ 1400Z-1 to -2 (providing no such limits); Treas. Reg. § 1.1400Z2(a)-1 to (f)-1 (same); Lester et al., *supra* note 85, at 224 (describing the procedure for investor eligibility). Taxpayers fill out an IRS Form 8949 and attach it to the tax return of the taxable year they would have included gains in gross income if not for the deferral. Treas. Reg. § 1.1400Z2(a)-1(a)(2); *see also* I.R.S. Pub. 550 (Mar. 28, 2019) (providing instructions to elect for deferral of capital gains investing in QOFs).

[94] LISA CHRISTENSEN GEE & LORENA ROQUE, STATES SHOULD DECOUPLE FROM COSTLY FEDERAL OPPORTUNITY ZONES AND REJECTS LOOK-ALIKE PROGRAMS 4 (2019). This includes Alabama, Arkansas, Connecticut, Louisiana, Maryland, Ohio, Rhode Island, and Wisconsin. *Id.* Other than Louisiana, Maryland, Rhode Island, and Wisconsin, each of these states provide an additional state investment tax credit. *Id.* For example, Louisiana freezes property taxes in Opportunity Zones for up to ten years. *Id.* Maryland gives local municipalities the choice to offer additional property tax reductions to investors. *Id.* Rhode Island exempts capital gains from state taxation if the taxpayer invested the gains in an Opportunity Zone fund for just seven years, as opposed to ten years under federal requirements. *Id.* Wisconsin exempts an additional 10% reduction in state capital gains if the taxpayer invested the gains in a Wisconsin Opportunity Zone for five years, and an additional 15% after seven years. *Id.*

[95] Lester et al., *supra* note 85, at 224, 226–27; *see infra* notes 96–101 and accompanying text (discussing the differences between the Opportunity Zone program and the LIHTC and the NMTC).

[96] *See* Lester et al., *supra* note 85, at 224 (explaining how taxpayers participate in the Opportunity Zone program).

[97] *See* I.R.C. § 1400Z-2(d) (providing requirements for QOFs); Lester et al., *supra* note 85, at 224 (discussing the lack of restrictions on qualifying investments).

[98] Treas. Reg. § 1.1400Z2(d)-1(a)(1); Lester et al., *supra* note 85, at 224.

[99] Lester et al., *supra* note 85, at 226–27.

[100] *Id.* at 227.

[101] *Id.*; *see* I.R.C. §§ 1400Z-1 to -2 (providing no such limits); Treas. Reg. § 1.1400Z2(a)-1 to (f)-1 (same).

B. Critical Assessment of Federal Place-Based Investment Tax Incentives

Despite the early optimism surrounding place-based investment tax incentives, even their initial supporters were aware that residents were at risk of displacement as real estate and land values rose.[102] In the intervening decades, those who have studied place-based tax expenditures have questioned their effectiveness on several fronts.[103] Subsection One discusses federal place-based investment tax incentives and their uneven economic track record.[104] Subsection Two describes the potential of collateral effects on communities.[105]

1. An Uneven Economic Track Record

Federal place-based investment tax incentives enjoy bipartisan support for delivering benefits to low-income communities by leveraging for-profit, market-driven mechanisms.[106] The verdict is, however, decidedly mixed when evaluating these programs as anti-poverty measures.[107] To what extent program benefits reach their intended recipients is unclear.[108] One study compared rental costs in LIHTC-subsidized and market-rate rental units and found that about one-third of forgone tax revenue reaches low-income households in the form

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[102] *See, e.g.*, WILLIAM F. MCKENNA & CARLA A. HILLS, THE REPORT OF THE PRESIDENT'S COMMISSION ON HOUSING 107 (1982) (supporting enterprise zones incentives but expressing concern about possible displacement of zone residents), Butler, *supra* note 52, at 47 (recognizing that the more successful the initiative becomes, the more likely it will displace those it means to help); Hall, *supra* note 52, at 12 (noting that because American policymakers intend to designate existing neighborhood communities as enterprise zones, the dangers of displacement will exist where none did under the British model). Several proposals sought to salvage the approach as a solution to concentrated poverty. *See, e.g.*, MCKENNA & HILLS, *supra*, at 1067 (proposing measures to specifically address issues of affordable housing); Boeck, *supra* note 52, at 154 (detailing proposals in early federal enterprise zone bills to prevent displacement); Butler, *supra* note 52, at 48 (rebutting American enterprise zone critics who believe the only solution to avoid displacing local residents is to follow the British model of locating the zones in depopulated areas).

[103] STEUERLE, *supra* note 1, at 205–06.

[104] *See infra* notes 106–125 and accompanying text (discussing the economic impact of federal place-based investment tax incentives on racial segregation, gentrification, and economic growth).

[105] *See infra* notes 126–150 and accompanying text (describing critiques of the effects of federal place-based investment tax incentives on racial segregation and gentrification).

[106] *See* Layser, *supra* note 52, at 404–05 (describing the excitement among investors in reaction to new Opportunity Zone incentives in the TCJA); Layser, *supra* note 17, 757–58 (noting that federal place-based tax incentives have long garnered bi-partisan endorsement); *see, e.g.*, Molloy, *supra* note 76, at 48 (stating that because of the NMTC, investment dollars are funding projects benefitting low-income communities); *Top 25 Innovations in Government Announced*, HARV. KENNEDY SCH. ASH CTR. (May 2, 2011), https://ash.harvard.edu/news/top-25-innovations-government-announced-0 [https://perma.cc/J8YF-L7EH] (declaring the Treasury's NMTC program as one of the top twenty-five innovations of 2011 in improving regional economic development efforts).

[107] Neumark & Simpson, *supra* note 19, at 1279; *see, e.g.*, Hula & Jordan, *supra* note 22, at 24 (discussing the results from studies of the NMTC program).

[108] *See infra* notes109–116 and accompanying text (discussing the lack of evidence showing that community residents are better off after the passage of the LIHTC and NMTC programs).

of rent savings.[109] These results suggest that developers and investors capture a significant majority of benefits in administrative fees and profits, thus undermining the program's ability to deliver government expenditures to targeted populations.[110] Moreover, the LIHTC certification process requires developers only to report high-level figures on construction costs and not detailed breakdowns of payments to third-party contractors.[111] The program is, therefore, vulnerable to further misappropriation through fraud.[112]

The NMTC program fares little better.[113] The IRS has not established procedures to measure whether the program improves the lives of existing residents.[114] As a result, when the CDFI Fund and pro-NMTC groups report positive numbers on job creation and retention, for example, the figures are often mere estimates or rely on survey results from third parties using a limited sample size.[115] Because Treasury also does not require CDEs to report how much they charge in fees or interest rates for NMTC-subsidized capital investments and loans, any assessment of the program's ability to deliver benefits remains incomplete.[116]

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[109] Gregory S. Burge, *Do Tenants Capture the Benefits from the Low-Income Housing Tax Credit Program?*, 39 REAL EST. ECON. 71, 95 (2011). The amount that low-income households would save on rent constitutes between 26.7% and 51.3% of the cost to governments to offer the tax credit. *Id.* at 91.

[110] *Id.* at 95.

[111] GAO-18-637, *supra* note 7, at 37.

[112] *Id.*

[113] *Compare* U.S. GOV'T ACCOUNTABILITY OFF., GAO-14-500, NEW MARKETS TAX CREDIT: BETTER CONTROLS AND DATA ARE NEEDED TO ENSURE EFFECTIVENESS 15–16 (2014) [hereinafter GAO-14-500] (noting that Treasury officials lack data on the fees and interest CDEs levy even though higher charges mean less investment reaches businesses in low-income communities), *with* GAO-18-637, *supra* note 7, at 37 (discussing the LIHTC's susceptibility to fraud due to incomplete reporting data from real estate developers).

[114] *See* Hula & Jordan, *supra* note 22, at 26 (arguing that thus far, efforts to measure the impact of the NMTC do not ask whether the program "materially" improves the well-being of those living in low-income communities); *see also* INTERNAL REVENUE SERV., DEPT. OF THE TREASURY, NEW MARKETS CREDIT 1 (2010) (explaining that Congress intended for the NMTC-subsidized investments to "result in the creation of jobs and material improvement in the lives of residents in low-income communities").

[115] *See* Hula & Jordan, *supra* note 22, at 26 (noting that no one has yet conducted a full evaluation of the NMTC, measuring social and economic returns, as well as positive and negative externalities); *see, e.g.*, NEW MKTS. TAX CREDIT COAL., NEW MARKETS TAX CREDIT PROGRESS REPORT 7, 9 (2019) (claiming that the NMTC program created 58,300 jobs in 2019 based on survey data from 74 CDEs); MICHAEL SWACK ET AL., CDFIS STEPPING INTO THE BREACH: AN IMPACT EVALUATION—SUMMARY REPORT 7, 10 (2014) (discussing methodology and limitations of research on the impact of CDFI lending and investment).

[116] *See* GAO-14-500, *supra* note 113, at 16 (noting that so long as the CDFI Fund does not collect CDE disclosures on fees, interest, and other costs, the lack of data limits Treasury's analysis of the net economic benefit to low-income businesses); CHARLES DELUCA ET AL., CONG. BUDGET OFF., THE NEW MARKETS TAX CREDIT: A CRITICAL ASSESSMENT 9 (2011) (observing that CDEs incur high transaction costs at the onset from merely setting up the legal entity).

Broader economic indicators also yield ambiguous results.[117] For example, in one study, researchers observed rising home prices, lower crime rates, and more racially and economically diverse communities where there were LIHTC developments.[118] Yet, without the ability to study a true counterfactual—meaning an alternative scenario in which these developments never occurred—we cannot definitively attribute these results to the policy intervention.[119] Indeed, several studies show that projects funded by the LIHTC and NMTC tend to crowd out unsubsidized development, which is to say, these projects may have happened even without spending taxpayer money.[120] Furthermore, where one Texas researcher did manage to study a counterfactual over a relatively long period of time, any positive changes observed in home values, job quality, private-sector employment, and poverty rates were modest as to be statistically negligible.[121]

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[117] *See* Hula & Jordan, *supra* note 22, at 26 (noting that studies have not shown that the NMTC substantially enhances the lives of residents in targeted communities). *Compare* Diamond & McQuade, *supra* note 5, at 1065 (discussing study results showing that the LIHTC integrates communities, raises home values, and decreases crime and violence), *with* Eriksen & Rosenthal, *supra* note 66, at 954 (explaining that LIHTC-subsidized units primarily benefit moderate, as opposed to low-income, tenants and tend to crowd out other affordable housing developments), *and* Nathaniel Baum-Snow & Justin Marion, *The Effects of Low Income Housing Tax Credit Developments on Neighborhoods*, 93 J. PUB. ECON. 654, 665 (2009) (showing that LIHTC-subsidized construction tends to crowd out private rental construction, especially in gentrifying areas).

[118] Diamond & McQuade, *supra* note 5, at 1065. Researchers here studied data from 129 counties from 1987 to 2012, including the location and funding dates of LIHTC projects, figures from home sales, and homebuyer race and income information. *Id.* at 1064, 1074.

[119] *See* Joseph A. Clougherty et al., *Correcting for Self-Selection Based Endogeneity in Management Research: Review, Recommendations and Simulations*, 19 ORGANIZATIONAL RES. METHODS 286, 287, 291 (2016) (explaining that randomized experiments are the "gold standard" for making causal claims in which researchers are able to study counterfactuals). Another recent study of the TCJA Opportunity Zone program on job growth recognized that "designated tracts [for preferential tax treatment] may differ systematically from those left undesignated" because of factors like governor discretion in selecting tracts "eligible to receive benefits." Alina Arefeva et al., Job Growth from Opportunity Zones 8 (Feb. 1, 2021) (unpublished manuscript), https://ssrn.com/abstract=3645507 [https://perma.cc/ZXS3-LMDA]. It attempted to control for these outside factors by "includ[ing] many controls for fixed characteristics of tracts and perform[ing] a variety of analyses to address the concern." *Id.* The study also compared its results to an approximate counterfactual *date* by "running a placebo test in which [it] pretend[s] that legislation for the [Opportunity Zone] program occurred [two years earlier] in 2015." *Id.* at 15. Under these design conditions, the study showed that, from 2017 to 2019, the program's impact was geographically disparate, with metropolitan areas seeing employment growth at between 3% to 4.5% for low-skilled workers while creating no jobs in rural areas. *See id.* at 2 (discussing the study's results).

[120] *See, e.g.*, Diamond & McQuade, *supra* note 5, at 1113 (explaining that without the ability to study a counterfactual, researchers could not discount crowd-out effects caused by the LIHTC); Hula & Jordan, *supra* note 22, at 26 (noting that only by assessing a counterfactual can researchers rule out the possibility that the NMTC is merely shifting investments that would have occurred absent the subsidy).

[121] Freedman, *supra* note 75, at 1013. Here, the study took advantage of the NMTC's threshold requirements for eligibility: communities must have at least a 20% poverty rate or a median family income not exceeding 80% of the greater of either the statewide or the metropolitan median family

The evidence further suggests that place-based tax incentives mainly benefit high-income individuals.[122] The TCJA Opportunity Zone provision, for example, can structurally favor the wealthy by allowing taxpayers to defer or, in some cases, exclude income from capital gains.[123] That capital gains taxation is concentrated in top income brackets makes the structure of the incentive undermine vertical equity—either the state's tax base shrinks or lower-income residents must bear more of the financial burden for government services.[124] And, because state income tax rates are already largely regressive, additional exclusions of capital gains from taxation further exacerbates this problem.[125]

2. Collateral Effects on Communities

Although it remains the most prolific driver of affordable housing construction, LIHTCs have been the target of long-standing criticism from civil rights groups.[126] The LIHTC program subsidizes a greater portion of costs for

income. *See* I.R.C. § 45D(e)(1) (providing eligibility requirements for the NMTC); Freedman, *supra* note 75, at 1002–04 (discussing the study's design). Apart from these income requirements, adjacent tracts were otherwise similar. Freedman, *supra* note 75, at 1001. The study tracked neighborhood changes over the course of a decade in the 2000s. *Id.* at 1004. Comparing adjacent tracts falling within a narrow range of poverty rates or median family income allowed the study to infer causality between NMTC investment and community outcomes. *Id.* at 1001.

122 *See, e.g.*, Sean Lowry & Donald J. Marples, *Tax Incentives for Opportunity Zones: In Brief*, 20 CURRENT POL. & ECON. U.S. CAN. & MEX. 597, 607 (2018) (finding that investment credits and incentives, like the NMTC and the Opportunity Zone program, mainly benefit capital owners, rather than the residents of economically distressed areas targeted for investment). The design of the Opportunity Zone tax incentive further amplifies the inequitable distribution of benefits because, unlike the NMTC, there is no cap on incentives conferred and no mechanism to ensure subsidized projects create "community outcomes." *Id.* at 607–08. Although President Donald Trump's Council of Economic Advisers claims that the Opportunity Zone program stands to lift one million Americans out of poverty, it assumes that the tax incentive's effects will be similar to those of the NMTC despite these significant differences in program design. THE COUNCIL OF ECON. ADVISERS, THE IMPACT OF OPPORTUNITY ZONES: AN INITIAL ASSESSMENT 25 (2020). Experts say that such a comparison is unwarranted and believe such claims of poverty alleviation require "a big leap of faith." Noah Buhayer, *White House Draws Doubts with Claims of $75 Billion for Poor Areas*, BLOOMBERG (Aug. 26, 2020), https://www.bloomberg.com/news/articles/2020-08-26/white-house-says-75-billion-going-to-poor-areas-it-s-debatable [https://perma.cc/FG8Y-MAYT].

123 *See* I.R.C. § 1400Z-2(b)–(c) (providing treatment and deferral of capital gains); *cf.* STEUERLE, *supra* note 1, at 248–49 (noting that capital gains taxation primarily concentrates in high-income earning tax brackets). Vertical equity is otherwise known as progressivity in the tax system. *Id.* at 11. In this narrow context, the principle calls for greater tax liability to fall on those with more ability to pay. *Id.* A broader interpretation of vertical equity asks the government to provide more to those with greater needs. *Id.*

124 *See* STEUERLE, *supra* note 1, at 11, 248–49 (describing principles of vertical equity and explaining that mainly the wealthy pay capital gains taxes).

125 *Cf.* ELIZABETH MCNICHOL, CTR. ON BUDGET & POL'Y PRIORITIES, STATE TAXES ON CAPITAL GAINS 2 (2018) (describing the regressive nature of state taxation of capital gains).

126 Orfield, *supra* note 5, at 105–06. For instance, in 2004, in *In re Adoption of the 2003 Low-Income Housing Tax Credit Qualification Plan*, plaintiffs brought suit in state court alleging that New Jersey state agencies violated the FHA by directing tax credits for affordable housing to poor, black

projects located in high-poverty areas.[127] Because Treasury also limits the amount of LIHTCs awarded annually to each state, these projects may come at the expense of affordable housing construction in areas with higher median incomes.[128] The combination of these administrative procedures, in effect, incentivizes developers to cluster LIHTC projects in low-income areas.[129] Due to intergenerational poverty and entrenched racial segregation, African American and Latino families make up a large portion of these communities.[130] Using data from the Department of Housing and Urban Development, researchers have shown that LIHTC units are located predominantly in poor minority neighborhoods.[131] The LIHTC program's effect on racial segregation could, however, be overstated if white, low-income tenants are moving into the newly-built units.[132] Nevertheless, because Treasury does not require reporting on racial or socioeconomic data about tenants who ultimately reside in subsidized units, we do not have a complete picture of the program's effects on a community's racial composition.[133]

Critics also maintain that the arrival of investments subsidized with federal place-based tax incentives coincides with the influx of high-income individ-

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neighborhoods. 848 A.2d 1, 9–10 (N.J. Super. Ct. App. Div. 2004); *see also* Orfield, *supra* note 5, at 138–44 (examining the case to highlight the tension between civil rights and state and federal low-income policies). The FHA requires the federal government and any agency operating on its behalf to "affirmatively further" fair housing. 42 U.S.C. § 3608(d). The parties' arguments illustrate a larger debate surrounding the effects of the LIHTC incentive structure. Orfield, *supra* note 5, at 104–05. On one side, the defendants were state officials who echoed traditional arguments supporting place-based programs. *Id.* at 140–42; *see In re 2003*, 848 A.2d at 14 (identifying parties to the case and their arguments). They contended that poor neighborhoods, irrespective of racial composition, needed capital investment, and LIHTC-subsidized construction would provide much needed housing and revive the local economy. *In re 2003*, 848 A.2d at 14–15. On the other, the plaintiffs were public interest advocates, including the Fair Share Housing Center for the NAACP, who asserted that concentrating federal and state-subsidized low-income housing exacerbated conditions for racial segregation and concentrated poverty. *Id.* at 5–6; Orfield, *supra* note 5, at 138–39. The court ultimately found for the defendants, ruling that state officials' actions did not constitute a violation of FHA duties even if the end result was greater racial segregation. *In re 2003*, 848 A.2d at 19. As codified, the LIHTC program gives preference to low-income neighborhoods, requiring state officials to allocate credits based on criteria that ignore race. *Id.* at 20. Their decisions did not, therefore, constitute a violation of FHA duties even if the end result was greater racial segregation. *Id.* at 20–21; Orfield, *supra* note 5, at 143.

[127] Layser, *supra* note 23, at 948–49.

[128] *Id.* at 950.

[129] *Id.* at 948.

[130] PATRICK SHARKEY, STUCK IN PLACE: URBAN NEIGHBORHOODS AND THE END OF PROGRESS TOWARD RACIAL EQUALITY 3, 9, 29 (2013); *see also* Layser, *supra* note 23, at 916 (discussing how segregation before the FHA created long-lasting barriers to integration).

[131] J. William Callison, *Achieving Our Country, Geographic Desegregation and the Low-Income Housing Tax Credit*, 19 S. CAL. REV. L. & SOC. JUST. 213, 245 (2010); *see also* Layser, *supra* note 23, at 927–28 (explaining the distribution of low-income housing projects). Developers have built 43% of LIHTC-subsidized units in neighborhoods with over half of the residents representing minority populations. Callison, *supra*, at 245. This number rises to 60% for development in urban areas. *Id.*

[132] Orfield, *supra* note 5, at 135–36.

[133] *Id.*

uals to the exclusion and detriment of the poor.[134] In the aforementioned Texas study of NMTC-subsidized investments, areas that saw decreases in poverty and unemployment rates also saw higher rates of household turnover.[135] These results led researchers to suggest that a demographic shift partly drove the improvement, rather than any changes in the lives of existing residents.[136] This demographic change was the inward migration of more affluent individuals into the low-income community, displacing existing residents—otherwise known as gentrification.[137] Even discounting gentrification effects, the evidence also suggests that any new employment opportunities arising from NMTC-subsidized investments primarily go to skilled workers outside of targeted poor communities rather than to existing residents.[138]

Recent studies, however, paint a nuanced picture.[139] One analysis found that inward migration of new residents and outward displacement of existing residents are not inextricably linked.[140] Medicaid claims data showed that low-income children were no more likely to move out of New York City neighborhoods experiencing an influx of affluent residents than children in neighborhoods that remained economically stagnant.[141] The result remained unchanged, no matter whether the children lived in rent-controlled or market-rate housing.[142] Another study of U.S. Census Bureau data revealed that although inward migration increased the likelihood that existing low-income residents

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[134] Layser, *supra* note 17, at 777.

[135] Freedman, *supra* note 75, at 1013; *see also supra* note 121 and accompanying text (discussing results from one study showing modest improvements in home values, job quality, private-sector employment, and poverty rates in areas hosting NMTC-subsidized development projects).

[136] *Id.*

[137] Layser, *supra* note 17, at 777.

[138] Matthew Freedman, *Place-Based Programs and the Geographic Dispersion of Employment*, 53 REG'L SCI. & URB. ECON. 1, 13 (2015). In a study of all NMTC-subsidized investments through 2009, targeted areas saw an influx of jobs that are mid-wage (paying between $15,000 and $39,999 per year) and high-wage (paying $40,000 or more per year). *Id.* at 7. The number of residents employed within their communities, however, dropped, while the average length of their commutes rose. *Id.* at 7–9. These results led researchers to conclude that the existing low-income residents did not receive most of the newly created jobs from NMTC-subsidized investments. *Id.* at 9.

[139] *See infra* notes 140–144 and accompanying text (discussing results from recent gentrification studies). *Compare* Quentin Brummet & David Reed, *The Effects of Gentrification on the Well-Being and Opportunity of Original Resident Adults and Children* 5 (Fed. Rsrv. Bank of Phila., Working Paper, No. 19-30, 2019) (discussing results and methodology from a study of the effects of gentrification on communities), *and* Kacie Dragan et al., *Does Gentrification Displace Poor Children and Their Families? New Evidence from Medicaid Data in New York City*, REG'L SCI. & URB. ECON. 1, 2 (2019) (same), *with* Freedman, *supra* note 75, at 1013 (arguing that because of higher household turnover, any improvement in economic indicators is partly due to the displacement of existing residents), *and* Layser, *supra* note 17, at 764 (asserting that, without mitigating protections for local residents, the likely outcome of gentrification is the loss of homes and employment to wealthier outsiders).

[140] *See* Brummet & Reed, *supra* note at 139, at 6–7, 24–25 (defining gentrification and base measurements and providing study results); Dragan et al., *supra* note 139, at 2, 8 (same).

[141] Dragan et al., *supra* note 139, at 8–11.

[142] *Id.* at 4.

would leave the area, displaced residents did not find themselves in more impoverished neighborhoods or in a worse-off position than residents moving out of areas not experiencing demographic change.[143] To the extent that federal place-based investment tax incentives create spaces encouraging an inward migration of the affluent, their effects on existing residents may not be as dire as previously feared.[144]

Adding further complexity to the analysis is the relative paucity of accurate longitudinal data to inform studies on gentrification.[145] Researchers must therefore rely on proxy data and make assumptions that have profound effects on study results.[146] For instance, to gain an accurate picture of displacement, studies must first identify neighborhoods that are, in fact, undergoing gentrification.[147] However, a multitude of variables exists to serve as indicators of gentrification, ranging from the more intuitive to the more creative.[148] The variables researchers ultimately select determine the number and type of neighborhoods studied and the ability of these factors to accurately describe change.[149] Even taking these ambiguities into account, any quantitative analysis will fail to account for the social and psychological ties people have to their communities or the barriers gentrification may impose on later housing prospects.[150]

II. Ineffective Federal Place-Based Investment Tax Incentives and the Dilemma for States

Given the equivocal performance of past place-based investment tax incentives, the question thus becomes how states respond when Congress enacts these expenditures.[151] Eighteen states choose to calculate their residents' tax

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[143] Brummet & Reed, *supra* note 139, at 24–25.

[144] *See id.* (discussing results from their analysis of Census Bureau data); Dragan et al., *supra* note 139, at 8–12 (explaining conclusions drawn from Medicaid data).

[145] Sue Easton et al., *Measuring and Mapping Displacement: The Problem of Quantification in the Battle Against Gentrification*, 57 URB. STUD. 1, 11 (2020). Longitudinal data monitors change measured over time. *Id.*

[146] *Id.* at 3. Proxy data are substitutes researchers use when direct measurements are unavailable. *Proxy Data*, EUROPEAN QUALITY ASSURANCE IN VOCATIONAL EDUC. & TRAINING, https://www.eqavet.eu/eu-quality-assurance/glossary/proxy-data [https://perma.cc/Q47H-SEBG].

[147] Easton et al., *supra* note 145, at 3.

[148] *Id.* at 3–4. The more intuitive indicators include proximity to downtown, low but rising median income compared to the area average, rising owner-occupied housing prices, or growing resident educational attainment compared to the city average. *Id.* The more creative ones include an area's proximity to parks and other green spaces, whether it is experiencing an influx of resident artists, or whether *The New York Times* covered the area in a gentrification exposé. *Id.*

[149] *Id.* at 3. Other issues with quantitative studies of gentrification include identifying displacement caused by gentrification to the exclusion of other forces, creating spatial areas that circumscribe displacement, and overcoming the weaknesses in available raw data. *Id.* at 7.

[150] *Id.* at 2.

[151] *See* Mason, *supra* note 9, at 1278 (discussing the varying impact between states that adopt different definitions of income and the timing by which their tax code conforms with federal tax law).

liability based on a version of the Code as it existed at some point in time.[152] Under this fixed-date system, state legislatures must opt-in and amend existing state law to adopt provisions newly enacted at the federal level.[153] By contrast, the District of Columbia and eighteen states dynamically mirror federal updates by using the most current version of the Code to calculate their residents' state tax liability.[154] Under this system, when confronted with new additions to the Code, states must opt-out to selectively exclude federal provisions from applying at the state level.[155] States exclude, or "decouple," from select federal tax provisions by requiring residents to add back federal deductions or exemptions when calculating their state tax liabilities.[156]

Citing a dearth of favorable outcomes from past place-based interventions, some states have chosen to specifically decouple from the most recent Opportunity Zone provisions contained in the Tax Cuts and Jobs Act of 2017 (TCJA).[157] Beyond concerns around its inefficacy as a poverty-reduction tool,

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For the seven states with no individual income tax, and the two states exempting wages and capital gains from taxable income, federal tax law has minimal impact on the state's tax base. *See* FED'N OF TAX ADM'RS, *supra* note 12, at 1 (listing statutory tax regime by state); Mason, *supra* note 9, at 1314 (discussing states that primarily raise revenue through sales and property taxes). The states with no individual income tax are Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. FED'N OF TAX ADM'RS, *supra* note 12, at 1. New Hampshire and Tennessee levy taxes solely on interest and dividend income. *Id.* Five states have an individual income tax but choose to eschew federal definitions of income altogether. *Id.*; Mason, *supra* note 9, at 1278. Nonconforming states include Alabama, Arkansas, Mississippi, New Jersey, and Pennsylvania. FED'N OF TAX ADM'RS, *supra* note 12, at 1. Although these states do not use federal AGI or taxable income to calculate state taxes, they will often use federal calculations as a component of their tax regime. Mason, *supra* note 9, at 1278. For example, reported wages will take amounts from federal Form W-2, business income from federal Schedule C, and capital gains and losses from federal schedule D. *Id.*

[152] FED'N OF TAX ADM'RS, *supra* note 12, at 1. These states include Arizona, California, Georgia, Hawaii, Idaho, Indiana, Kentucky, Maine, Massachusetts, Minnesota, North Carolina, Ohio, Oregon, South Carolina, Vermont, Virginia, West Virginia, and Wisconsin. *Id.*

[153] Mason, *supra* note 9, at 1333. Static conformity allows legislatures to better consider the effects that changes would have on states but requires amendments to maintain conformity with federal legislation. *Id.*

[154] FED'N OF TAX ADM'RS, *supra* note 12, at 1. These states include Colorado, Connecticut, Delaware, Illinois, Iowa, Kansas, Louisiana, Maryland, Michigan, Missouri, Montana, Nebraska, New Mexico, New York, North Dakota, Oklahoma, Rhode Island, and Utah. *Id.*

[155] *See* Mason, *supra* note 9, at 1346 (using state legislatures with biennial sessions as an example of systems with significant limitations to pass tax legislation). States following both fixed-date conformity and dynamic conformity with federal tax law must have their legislature vote in favor of new federal tax credits before those credits can lower state tax liabilities, even if the provisions already reduce federal taxes their residents owe. *See id.* at 316 & n.210 (explaining that states generally adopt federal tax credits through specific state statutes); MINN. STAT. § 290.0671 (2020) (providing an earned-income tax credit as a percentage of income).

[155] Mason, *supra* note 9, at 1341.

[156] *Id.* at 1277. Most states, for example, require residents to add back any federal deductions for amounts paid to state and local taxes, as well as federal exemptions for interest income accrued from out-of-state bonds. *Id.*

[157] GEE & ROQUE, *supra* note 94, at 3. Of the states conforming to federal definitions of income, only California, North Carolina, and Mississippi have opted out of the TCJA Opportunity Zone pro-

federal place-based investment tax incentives also have the potential to shrink state budgets and constrain the ability of states to drive their own community development policies.[158] Decoupling from such provisions does, however, have some drawbacks.[159] Section A of this Part examines the financial cost of adopting these types of tax expenditures into state tax law and the constraints they impose on state policymaking autonomy.[160] Section B considers the downsides of excluding federal place-based investment tax incentives from state tax law.[161]

A. The Price of Conforming to Federal Definitions of Income

All things equal, federal place-based investment tax incentives decrease government revenue by shrinking the tax base.[162] Like direct spending, the

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gram. *Id.* The California state legislature let lapse a bill that would have incorporated federal law into the state tax code despite the Governor's endorsement of the program. Laura Mahoney, *Fellow Democrats Stop California Governor's Opportunity Zone Push*, BLOOMBERG TAX (Sept. 11, 2019), https://news.bloombergtax.com/daily-tax-report-state/fellow-democrats-stop-california-governors-opportunity-zone-push [https://perma.cc/N9YC-P29Z]. North Carolina specifically decouples from sections 1400Z-1 and 1400Z-2 of the IRC but does offer a tax credit for rehabilitating railroad stations located within Opportunity Zones. *See* N.C. GEN. STAT. § 105-130.5(a)(26)–(27) (2020) (providing that taxpayers must add back to federal taxable income any gain they would have included but for section 1400Z-2 of the Code to determine state net income); H.B. 399, 2019 Gen. Assemb. (N.C. 2019) (enacted) (providing a tax credit to taxpayers with qualified rehabilitee expenditures of at least $10 million to rehabilitate railroad stations meeting certain requirements, one of which is its location in an Opportunity Zone). Hawaii offers state tax breaks only for investments in Opportunity Zones within state borders. S.B. 1130, 30th Leg. (Haw. 2019) (enacted).

[158] *See* Mason, *supra* note 9, at 1289–94 (discussing the impact of the federal tax expenditures on state budgets and their ability to define state tax policy). Thirty states and the District of Columbia use federal AGI as the basis for their calculations, while six states start with the federal definition of taxable income. FED'N OF TAX ADM'RS, *supra* note 12, at 1. The states using the federal AGI as a starting point include Arizona, California, Connecticut, Delaware, Georgia, Hawaii, Illinois, Indiana Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, New Mexico, New York, North Carolina, Ohio, Oklahoma, Rhode Island, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. *Id.* The remaining states—Colorado, Idaho, North Dakota, Oregon, and South Carolina—start with the federal definition of taxable income. *Id.* States using federal taxable income conform more closely with the federal tax base because the definition of federal taxable income accounts for below-the-line deductions. Mason, *supra* note 9, at 1276. Most states conforming with federal AGI are equally beholden to federal tax policy because they often allow their residents to take a standard deduction as defined at the federal level, and many have itemized deductions mirroring those on their federal tax return. *Id.*

[159] *See* Erin Adele Scharff, *Laboratories of Bureaucracy: Administrative Cooperation Between State and Federal Tax Authorities*, 68 TAX L. REV. 699, 705–06 (2015); *infra* notes 190–205 and accompanying text (describing the downsides of decoupling from federal place-based tax incentives and more broadly, federal tax law).

[160] *See infra* notes 162–189 and accompanying text (discussing the fiscal implications of conformity and considering the tradeoff states make in regulatory independence when adopting federal place-based investment tax incentives).

[161] *See infra* notes 190–205 and accompanying text (considering the drawbacks states face when decoupling from federal tax law).

[162] *See* Surrey, *supra* note 3, at 725–26 (addressing a key criticism of tax incentives). The total value of all income, property, and wealth that a legislative authority decides to tax within its jurisdic-

forgone revenue shrinks the public budget while subsidizing taxpayers to achieve social and economic goals.[163] How Congress sets its tax expenditure budget can also impact how much revenue state governments collect from their residents.[164] Although states have independent taxation power, they often "conform" to federal definitions of income and determine a resident's total taxable income based on the figure calculated after federal exclusions, deferrals, and deductions.[165] Therefore, even if conforming states do not explicitly agree to subsidize federal place-based policies, they nevertheless forgo state tax revenue because these federal tax expenditures have already reduced their residents' taxable income.[166] In the case of TCJA Opportunity Zone incentives, because qualifying taxpayers may exclude capital gains from federal calculations of taxable income, they will also see a reduction in their state tax bill if they reside in a state calculating tax liabilities using federal figures.[167]

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tion constitutes its tax base. SMITH & SMITH, *supra* note 41, § T225. When multiplied by the applicable tax rate, this figure determines how much revenue flows into public coffers during each taxable period. Steven V. Melnik & David S. Cenedella, *Real Property Taxation and Assessment Processes: A Case for a Better Model*, 12 N.Y.U. J. LEGIS. & PUB. POL'Y 259, 265 (2009). Policymakers sometimes calculate the impact of tax expenditures using the assumption that an increase in revenue-generating activity will prevent a reduction in the tax base. *See* Surrey, *supra* note 3, at 726 (arguing that if the government program does stimulate economic growth, then the effect on the tax base might be mitigated). Only an increase in economic activity as a result of tax incentives will prevent a reduction in the tax base. *Id.* at 726.

[163] Surrey, *supra* note 3, at 706; *see also* Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Processes*, 43 B.C. L. REV. 863, 875 (2002) (explaining that giving federal tax breaks and spending federal revenue are effectively equivalent from a budgetary standpoint). Tax expenditures are a form of government spending that represent deviations from the general income tax structure and can result in foregone tax revenue equal to or exceeding direct expenditures. Surrey, *supra* note 3, at 706, 711. A sample of taxes the government could have collected includes those incentivizing charitable giving ($183.4 billion), research and development ($69.8 billion), green energy ($21.2 billion), earning income ($366.5 billion), saving for retirement ($100.9 billion), and education ($91.4 billion). *See* JOINT COMM. ON TAX'N, JCX-55-19, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2019–2023, at 20, 21, 26, 28, 30 (Comm. Print 2019) (providing total estimated expenditures for 2019 to 2023 for deductions for charitable deductions, credits for increasing research activities under section 41 of the Code, the energy credit, the earned income tax credit, individual retirement accounts, and credits for tuition for post-secondary education); Schizer, *supra* note 8, at 284 (providing a similar list using 2014 figures). These estimates are rough and do not indicate how much revenue Congress would save if it were to eliminate the expenditures because they do not account for the way in which different provisions in the Code affect each other. Schizer, *supra* note 8, at 284 & n.51; *see also* TAX POL'Y CTR., THE TAX REFORM TRADEOFF: ELIMINATING TAX EXPENDITURES, REDUCING RATES 21 (2018) (describing "interaction effects").

[164] *See* Field, *supra* note 9, at 536 & n.24 (noting that states have chosen to decouple from federal provisions affecting the taxable corporate income).

[165] *State & Local Taxation*, *supra* note 29, § 56; Field, *supra* note 9, at 536–37.

[166] *See* Mason, *supra* note 9, at 1292–94 (explaining that by adopting federal definitions of income, states use their tax revenue to support the activities Congress had decided to subsidize).

[167] *See id.* (describing the effects of tax expenditures on the tax base of states conforming to federal definitions of income). Although Alabama, Arkansas, New Jersey, and Pennsylvania do not generally conform to federal definitions of income, these states have chosen to specifically forego state tax revenue in order to subsidize the TCJA Opportunity Zone program. *See* FED'N OF TAX ADM'RS,

As proceeds from income taxes make up a growing proportion of the tax base for many states, federal programs have become an increasingly costly line item in state budgets.[168] From 1975 to 2000, the proportion of personal income tax became the leading contributor to state treasuries, rising from 23.5% to 37% of overall state tax proceeds.[169] Few states routinely measure the cost of conforming to federal place-based investment tax incentives.[170] The cost of conformity, in general, can represent a significant percentage of a state's overall tax expenditure budget.[171] And, although conformity with federal place-based investment tax incentives may only comprise a small portion of overall state tax expenditures, states are also subject to fiscal pressures absent at the federal level.[172] Forty-four states and the District of Columbia have balanced

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supra note 12, at 1 (detailing federal starting points for the calculation of personal income tax by state); Mason, *supra* note 9, at 1293 (explaining that if a state imports federal tax expenditures in calculating its resident's state tax liabilities, then the state forgoes tax revenue to subsidize the federal provision). Massachusetts tax residents do not benefit from additional reductions to their state tax bill as a result of the Opportunity Zone program because the state adopts the federal definition of adjusted gross income as of January 1, 2005, before the enactment of the TCJA. *See* MASS. GEN. LAWS ch. 62, §§ 1(c), 2(a) (2020) (providing that with certain modifications, Massachusetts gross income means federal gross income as defined by the Code as it stood on January 1, 2005).

[168] *See* WALTER HELLERSTEIN ET AL., STATE TAXATION ¶ 20.01 (3d ed. 2019) (explaining the changing composition of state tax bases); Mason, *supra* note 9, at 1293 (describing how states conforming to federal definitions of income subsidize federal tax incentives using state tax revenue). Only seven states levy no personal income tax; Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. FED'N OF TAX ADM'RS, *supra* note 12, at 1. Tennessee and New Hampshire assess taxes on interest income and dividends. *See* N.H. REV. STAT. ANN. § 77:1–:37 (2020); TENN. CODE ANN. § 67-2-102 (2020).

[169] HELLERSTEIN ET AL., *supra* note 168, ¶ 20.01.

[170] *See* MICHAEL LEACHMAN ET AL., CTR. ON BUDGET & POL'Y PRIORITIES, PROMOTING STATE BUDGET ACCOUNTABILITY THROUGH TAX EXPENDITURE REPORTING 3 (2011) (discussing the general lack of rigorous reporting on tax expenditures at the state level). For example, of the thirty-seven states conforming to the TCJA Opportunity Zone program, only Georgia, Maine, Maryland, Oregon, and Wisconsin have calculated its cost to the state. *See* WIS. DIV. OF EXEC. BUDGET & FIN., DEP'T OF ADMIN. & WIS. DIV. OF RSCH. & POL'Y, DEP'T OF REVENUE, SUMMARY OF TAX EXEMPTION DEVICES 19 (2019) [hereinafter SUMMARY OF TAX EXEMPTION] (estimating that the Opportunity Zone program will cost $10 million in 2019 with ongoing costs thereafter); FISCAL RSCH. CTR. OF THE ANDREW YOUNG SCH. OF POL'Y STUDS. AT GA. STATE UNIV., GEORGIA TAX EXPENDITURE REPORT FOR FY 2021, at 110 (2019) [hereinafter GEORGIA TAX EXPENDITURE] (estimating that the Opportunity Zone program will cost $15 million over three years); FED'N OF TAX ADM'RS, *supra* note 12, at 1 (providing the list of thirty-seven states who conform to federal definitions of income); JOINT STANDING COMM. ON TAX'N, DEP'T OF ADMIN. & FIN. SERVS., MAINE STATE TAX EXPENDITURE REPORT 2020–2021 & MAINE TAX INCIDENCE STUDY 67 (2019) [hereinafter MAINE STATE TAX EXPENDITURE] (estimating that the Opportunity Zone program will cost between $3 million and $5 million over two years); OR. DEP'T OF REVENUE RSCH. SECTION, STATE OF OR., STATE OF OREGON TAX EXPENDITURE REPORT: 2019–2021, at 31 (2018) [hereinafter OREGON TAX EXPENDITURE] (estimating that the Opportunity Zone program will cost $15.9 million over three years).

[171] ARAVIND BODDUPALLI ET AL., TAX POL'Y CTR., STATE INCOME TAX EXPENDITURES 3 (2020). For instance, conforming with federal tax law makes up 85% of state tax expenditures in California and Minnesota, and 72% in the District of Columbia and Massachusetts. *Id.*

[172] *Compare* KIM RUEBEN & MEGAN RANDALL, BALANCED BUDGET REQUIREMENTS: HOW STATES LIMIT DEFICIT SPENDING 1 (2017) (describing the many antideficit provisions applicable to

budget requirements barring them from spending more than they collect in revenue.[173] Here, statutes limit the legislature's capacity to bridge any shortfalls in state budgets by issuing debt.[174] Therefore, to continue conforming to increasingly expensive federal tax incentives, states must make the politically sensitive decision to either raise tax rates or cut spending.[175]

Moreover, states face additional uncertainties when deciding whether to opt-in or opt-out of federal place-based investment tax incentives.[176] Because the IRS does not comprehensively collect, track, or analyze data from any of its tax expenditure programs, states do not know whether place-based investment tax incentives have had their intended effect, nor how to optimize programs if they have not.[177] Whether the provision misappropriates revenue and how much relinquished revenue goes towards administrative costs are also unknowns.[178] Furthermore, proposed and final regulations for any given new federal tax provision may differ significantly, and this divergence can have major implications.[179] For example, as compared to the proposed regulations, final

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states), *with* Evan O'Connor, Note, *Caught Off-Balance: How Implementing Structural Changes to State Balanced Budget Requirements Can Foster Fiscal Responsibility and Promote Long-Term Economic Health*, 56 B.C. L. REV. 351, 354 n.19 (2015) (noting that although many lawmakers have demanded a constitutional amendment to include a balanced budget requirement, the federal government is not subject to such a mandate), *and* Tara Golshan, *House Republicans Are Voting to Make Deficits Unconstitutional After $1.5 Trillion Tax Cut*, VOX (Apr. 12, 2018), https://www.vox.com/policy-and-politics/2018/4/12/17216828/balanced-budget-amendment-trump-ryan-tax [https://perma.cc/3WFV-3J6Q] (reporting on recent Republican efforts to pass a balanced budget amendment).

[173] RUEBEN & RANDALL, *supra* note 172, at 1.

[174] Mason, *supra* note 9, at 1308.

[175] *Id.*

[176] *See* Field, *supra* note 9, at 540–43 (explaining that a state's tax base shrinks when it conforms to tax expenditures adopted at the federal level); Mason, *supra* note 9, at 1320 (explaining that decoupling from federal tax law provides states more fiscal stability because it minimizes their exposure to revenue disruptions resulting from new or amended federal tax expenditures).

[177] STEUERLE, *supra* note 1, at 198; *see, e.g.*, Stephanie Cummings, *O-Zone Investment Numbers Could Be Vast Underestimate*, TAX NOTES (Jan. 17, 2020), https://www.taxnotes.com/tax-notes-today-federal/opportunity-zones/o-zone-investment-numbers-could-be-vast-underestimate/2020/01/17/2c2vn [https://perma.cc/L43J-7CS8] (noting that neither the IRS, nor any other official government body collects data on investments in qualified Opportunity Zones and that data from private third-party sources may greatly underestimate how much money taxpayers are investing in qualified opportunity funds); Jad Chamseddine, *Republican Senators Boost O-Zone Reporting Requirements*, TAX NOTES (Dec. 9, 2019), https://www.taxnotes.com/tax-notes-today-federal/opportunity-zones/republican-senators-boost-o-zone-reporting-requirements/2019/12/09/2b6gh [https://perma.cc/Y8R5-K4VB] (discussing a Senate bill mandating that the Treasury collects information on QOF investments).

[178] *See* STEUERLE, *supra* note 1, at 198 (explaining that despite the reforms passed in 1998 seeking to modernize the IRS, it still lacks information systems to monitor outcomes of federal tax expenditure programs).

[179] *See* Mason, *supra* note 9, at 1294 (explaining that by conforming to federal tax law, states cede regulatory authority to Treasury); Stephanie Cummings, *Final O-Zone Regs Include Several Taxpayer Wins*, TAX NOTES (Dec. 30, 2019), https://www.taxnotes.com/taxpractice/opportunity-zones/final-o-zone-regs-include-several-taxpayer-wins/2019/12/30/2bq58 [https://perma.cc/24PW-

regulations for the TCJA Opportunity Zone incentive provided additional tax breaks to investor taxpayers.[180] Having made budget projections by relying on proposed regulations, conforming states could see an even greater decrease in revenue than they previously estimated as a result.[181]

Lastly, if federal tax incentives fail to show positive outcomes while pursuing goals in an area traditionally under state purview, issues of regulatory autonomy also arise.[182] Because their effects cascade beyond the impact on one

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KQW5] (discussing the differences between final and proposed regulations for the TCJA Opportunity Zone program).

[180] *See* Cummings, *supra* note 179 (reporting on several rules in the final regulations treating taxpayers more favorably than those in the proposed regulations). For example, final regulations allowed taxpayers to invest the total gains from the sale of business property into a QOF without waiting until the end of the year to offset gains with any losses from the sale of business property. DEP'T OF TREASURY, FINAL REGULATIONS ON OPPORTUNITY ZONES: FREQUENTLY ASKED QUESTIONS (Dec. 19, 2019), https://home.treasury.gov/system/files/136/Treasury-Opportunity-Zone-Final-Regulations-FAQ-12-19-19.docx [https://perma.cc/DCK8-62XU] (providing that taxpayers can invest the entire amount of capital gains from the sale of business property without having to wait until year-end to calculate net amount after losses). Typically, gains on the sale of business property under section 1231 are calculated at the end of the year by offsetting any gains against losses on the sale of business property. I.R.C. § 1231(a)(1). In the second version of the proposed regulations, the rule would have taxpayers wait until the end of the year to invest any gains into the QOF if they wished to benefit from the section 1400Z-2 deferral because only then could the taxpayer determine total aggregate gains, if any, under section 1231. Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18659 (proposed May 1, 2018) (to be codified at 26 C.F.R. pt. 1). Final regulations allow taxpayers to invest the entire amount of capital gains from the sale of section 1231 property within 180 days from the day of sale or exchange of property without reducing the gains by any losses. *Id.*

[181] *See* Field, *supra* note 9, at 540 (describing how modifications to federal tax law can reduce tax revenue); Mason, *supra* note 9, at 1308 (explaining that changes to federal tax law can substantially decrease state tax revenue); Samantha Jacoby, *Final Opportunity Zone Rule Could Raise Tax Break's Cost*, CTR. ON BUDGET & POL'Y PRIORITIES (Feb. 3, 2020), https://www.cbpp.org/blog/final-opportunity-zone-rules-could-raise-tax-breaks-cost [https://perma.cc/YF9A-FEAK] (reporting on the potential for the final regulations to increase the cost of the Opportunity Zone tax expenditure). Of the remaining thirty-seven states conforming to the Opportunity Zone program, only Georgia, Maine, Maryland, Oregon, and Wisconsin have calculated its cost to the state, and no state has re-estimated their figures based on Treasury's final regulations. *See* GEORGIA TAX EXPENDITURE, *supra* note 170, at 110 (reporting results prior to the December 2019 release of Treasury regulations relating to Opportunity Zone provisions); MAINE STATE TAX EXPENDITURE, *supra* note 170, at 67 (same); OREGON TAX EXPENDITURE, *supra* note 170, at 19 (same); OREGON TAX EXPENDITURE, *supra* note 170, at 31 (same). Seeking to decouple from the Opportunity Zone provision, the Maryland legislature proposed a bill after Treasury published the final regulations for the provision, and Maryland's budgetary estimates showed a total cost of $71.7 million between 2021 and 2025 to support the federal tax expenditure. DEP'T OF LEGIS. SERVS., MD. GEN. ASSEMBLY 2020 SESSION, FISCAL & POLICY NOTE FIRST READER: OPPORTUNITY ZONE TAX DEDUCTION REFORM ACT OF 2020, at 1 (2020); *see also* S.B. 263, 2020 Leg., 441st Sess. (Md. 2020). Because Maryland does not regularly calculate the cost of conforming to federal tax expenditures, state officials do not know how the estimate would have differed if calculated using proposed regulations. *See* MD. DEP'T OF BUDGET & MGMT., MARYLAND TAX EXPENDITURES REPORT 3 (2019) (noting that the state does not calculate the revenue foregone to support federal tax expenditures).

[182] *See* Mason, *supra* note 3, at 986, 992 (noting that Congress passes tax expenditures in several categories traditionally under state and local control, like housing, education, social services, health,

investor's tax return, federal place-based investment tax incentives may displace a state's own efforts to stimulate economic growth.[183] So long as federal tax incentives prioritize certain activities over others, they diminish a state's ability to enact competing policies—even if the state's lawmakers determine them to be in the state's best interest or a better expression of voter preference.[184] Consider the New Markets Tax Credits (NMTC).[185] CDEs funnel over half of their funds into commercial real estate.[186] The program's design nudges CDEs to invest in commercial real estate at a higher rate than they would absent the provision because doing so allows them to more easily maintain their certified status with the Treasury and to continue profiting from fees and interest charges.[187] If states determine that these types of projects are ill-suited for their communities, given the size of federal incentives, they might not easily counteract this incentive effect with their own tax policies.[188] Insofar as states are more knowledgeable of the local determinants important to a community's economic prospects, the displacement of state tax policy is all the more salient in the case of place-based incentives.[189]

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as well as community development, and that these federal tax expenditures present specific federalism issues).

[183] *See id.* at 993–94 (discussing federal tax expenditures and their crowd-out effect).

[184] *Id.*

[185] *See* Layser, *supra* note 52, at 414, 420 (using the NMTC as an example to draw a distinction between the economic and technical incidence of an indirect investment tax incentive).

[186] GAO-14-500, *supra* note 113, at 4.

[187] *See id.* at 16 (explaining the fees and compensation CDEs retain from NMTC transactions); Lauren Lambie-Hanson, *Addressing the Prevalence of Real Estate Investments in the New Markets Tax Credit Program*, 27–29 (Fed. Rsrv. Bank of San Francisco, Working Paper 2008-04, 2008) (discussing how the design of the NMTC creates incentives for CDEs to choose certain types of projects over others). Because "substantially all" of CDE funds must finance projects in qualifying low-income communities, the NMTC provision incentivizes CDEs to choose larger investments in commercial real estate whose borrowers pay back the principle over a longer period of time—alleviating the need for CDEs to continuously scout for new sound investments. *Id.* at 27. In addition, real estate projects, unlike other more mobile businesses, cannot relocate out of a qualified census tract, thus decreasing the risk that the projects would "grow out of compliance" and require the IRS to recapture from investors any tax credits attributable to their financing. *Id.* at 28–29.

[188] *See* Mason, *supra* note 3, at 993–94 (arguing that when the federal government uses tax expenditures to influence taxpayer activity in areas traditionally regulated by states, states are constrained in their ability to pursue competing policy goals).

[189] *See id.* at 993 (quoting Justice Brandeis and noting that states can conceive of different solutions to solve similar problems and serve as "laboratories" for "social and economic experiments" (quoting New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting))). *See generally* BARRY BLUESTONE, FED. RSRV. BANK OF BOS., WHAT MAKES WORKING CITIES WORK? KEY FACTORS IN URBAN ECONOMIC GROWTH 2–3 (2014) (discussing the local factors correlated with economic growth, such as transportation infrastructure, an educated workforce, variety of amenities, like restaurants and daycares, low crime rates, and business-friendly regulations and taxes).

B. The Costs of Opting Out

When decoupling from federal place-based investment tax incentives, states could, at a minimum, risk signaling that they are unfriendly to business interests or uncommitted to community development.[190] What is certain, however, is that when the same income is subject to two different tax systems, the burden of compliance increases.[191] Taxpayers earning income in multiple jurisdictions cannot expect similar tax treatment across different states.[192] To illustrate this problem, consider the relatively simple example of taxpayers who reside in Michigan, a conforming state, holding an Opportunity Zone real estate investment in California, a nonconforming state, for ten years.[193] If Michigan taxpayers sell their California holdings, any gains would escape taxation from both the federal and Michigan tax systems, while California would tax the profit at ordinary income rates.[194] In most other scenarios, taxpayers could expect to receive a Michigan credit for taxes they paid to another state on income from sources in that state.[195] Here, however, taxpayers may not be able to claim the credit, as Michigan did not impose taxation by virtue of its conformity with the Opportunity Zone provision.[196] Outcomes become more

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[190] *See* Mason, *supra* note 9, at 1322–24 (discussing the positive and negative signals states send when deviating from federal tax law). Taxpayer unfamiliarity with a state's motivations for decoupling is one explanation behind the power of such signaling. *Id.* at 1324. Taxpayers are likely more familiar with federal tax law and less likely to read state tax codes in their entirety, and likely do not seek to understand the legislative intent behind state statutory provisions. *Id.* As such, they are apt to infer broader attributions about a state government from deviations from federal tax law. *Id.*

[191] *Id.* at 1279–80. Electronic tax return preparation may mitigate compliance costs but not eliminate them entirely because taxpayers must still duplicate their efforts in tax-related recordkeeping and tax planning. *See* Scharff, *supra* note 159, at 706–07 (asserting that tax compliance costs from nonconformity persist even for wage-earning individuals with relatively simple finances); Lawrence Zelenak, *Complex Tax Legislation in the Turbo Tax Era*, 1 COLUMB. J. TAX L. 91, 92 (2010) (noting that tax preparation software reduces the difficulty of applying tax rules but offers limited assistance in keeping records and entering data).

[192] Mason, *supra* note 9, at 1282.

[193] *See* BLAKE CHRISTIAN & EDVIN GIVARGIS, THE STATE OF OPPORTUNITY ZONE INVESTING: A POWERFUL FEDERAL PROGRAM THAT REQUIRES CAREFUL STATE ANALYSIS 2 (2019) (discussing the implications for state taxes for individuals investing in Opportunity Zones).

[194] *See* I.R.C. § 1400Z-2(c) (providing for exclusion of capital gains from federal taxable income for investments held in QOF for at least ten years); CAL. REV. & TAX. CODE § 17024.5 (2020) (providing for fixed conformity of California's definition of adjusted income with the definition contained in the Code as it stood on January 1, 2015 for taxable years beginning on or after January 1, 2015); CAL. REV. & TAX. CODE § 17041(a)(2), (i) (providing the rates imposed on taxable income, defined as gross income less deductions "regardless of source," with no preferred treatment for capital gains); MICH. COMP. LAWS § 206.2 (2020) (providing for dynamic conformity of Michigan's definition of taxable income with the definition contained within the Code); Mahoney, *supra* note 157 (reporting on the California state legislature's decision to allow a bill applying federal Opportunity Zone provisions to state tax rules to lapse).

[195] MICH. COMP. LAWS § 206.255.

[196] *See id.* (providing for a credit against taxes due to Michigan for taxes on income derived from sources outside of the state so long as the income is also subject to taxes in Michigan).

complex when considering the numerous combinations of state taxation regimes, provisions and conformity rules applicable to any given taxpayer.[197] As a result, the cost of tax planning and compliance increases, and the lack of a unified tax regime creates barriers to interstate commerce.[198] Compliance costs become even more relevant in light of the high rates of interstate migration and investment.[199]

More generally, states decoupling from federal tax provisions must also resort to their own legislative resources to administer their tax systems without the ability to leverage Treasury's sophisticated rulemaking and enforcement capabilities.[200] Conforming states can refer to IRS liability assessments and federal court judgments.[201] These states also benefit by relying on the IRS to publish regulations and interpretive guidance.[202] State revenue departments can further harness federal expertise in drafting legislation and interpreting regulations.[203] Conforming states can also make use of federal withholding, auditing, and reporting requirements to enforce state tax law.[204] In addition, information exchange agreements with the Service can also facilitate state-level enforcement by keeping local tax authorities apprised of any federal deficiency rulings against their residents and allowing them to use the information filed in federal tax returns in their own audits.[205]

III. A THIRD WAY: EVALUATING FEDERAL PLACE-BASED INVESTMENT TAX INCENTIVES

Part I of this Note shows that it is questionable whether federal place-based investment tax incentives reduce poverty and deliver benefits to their

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[197] *See* CHRISTIAN & GIVARGIS, *supra* note 193, at 2–3 (asserting that the different combinations of state taxing regimes, provisions, and conformity rules could result in complex outcomes potentially catching taxpayers unawares).

[198] Scharff, *supra* note 159, at 706.

[199] *Id.* at 707.

[200] Mason, *supra* note 9, at 1280–81; *see also* Scharff, *supra* note 159, at 706–08 (discussing drawbacks for states decoupling from federal tax law).

[201] Mason, *supra* note 9, at 1281. Some nonconforming states have established their own tax courts. Scharff, *supra* note 159, at 708; *see* DOUGLAS L. LINDHOLM & FREDRICK J. NICELY, COUNCIL ON STATE TAX'N, THE BEST AND WORST OF STATE TAX ADMINISTRATION 1–8 (providing an overview of states' tax appeal processes and administrative practices).

[202] Scharff, *supra* note 159, at 708.

[203] Mason, *supra* note 9, at 1281. When state officials must develop their own knowledge base, they can also attend trainings organized by Treasury. *Id.*

[204] *Id.* at 1280. Because state income tax rates are much lower than federal rates, the cost of tax enforcement to the state is also proportionally higher than to the federal government. Scharff, *supra* note 159, at 708.

[205] Mason, *supra* note 9, at 1280–81.

intended beneficiaries.[206] These incentives further have the potential to segregate communities and displace existing residents.[207] Potentially ineffective federal tax incentives also have important consequences for states.[208] As discussed in Part II, federal place-based investment tax incentives can reduce state budgets and regulatory autonomy.[209] Nonetheless, conforming with federal tax law confers notable benefits.[210] Because of these tradeoffs, reflexively rejecting new federal place-based investment tax incentives may not be in a state's best interest.[211]

Instead, this Note argues that federal place-based investment tax incentives deserve special scrutiny.[212] That a state must opt-in or opt-out of these provisions does not obviate its responsibility to direct taxpayer dollars towards programs with measurable outcomes.[213] Therefore, state legislatures should

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[206] *See, e.g.*, Freedman, *supra* note 75, at 1013 (concluding that the modest growth from initiatives in Texas was concentrated in low wage jobs); *see also supra* notes 106–125 and accompanying text (describing results showing that economic gains from place-based incentives were negligible).

[207] *See, e.g.*, Callison, *supra* note 131, at 241–62 (explaining that results are mixed as to the effects of the LIHTC on the racial and socio-economic makeup of communities, and arguing that significant programmatic changes are necessary for the LIHTC to serve as a tool for desegregation); Freedman, *supra* note 75, at 1013 (attributing part of the improvements in poverty and unemployment rates in neighborhoods receiving NMTC-subsidized investments to gentrification because those same communities also saw higher rates of household turnover); *see also supra* notes 126–150 and accompanying text (describing the criticisms of place-based investment tax incentives with a focus on its effects on existing communities).

[208] *See, e.g.*, Mason, *supra* note 3, at 993–94 (discussing the crowd-out effects of federal tax expenditures in areas traditionally under state regulation).

[209] *See supra* notes 162–189 and accompanying text (discussing the price states pay for conforming to federal tax law).

[210] Mason, *supra* note 9, at 1280–82.

[211] *See id.* at 1320–31 (explaining the disadvantages of and obstacles to decoupling from federal tax law); *see also supra* notes 190–205 and accompanying text (describing the costs to states of decoupling from federal tax law).

[212] *See infra* notes 213–271 and accompanying text (proposing a framework for states to evaluate federal place-based investment tax incentives).

[213] *See* FOUND. FOR STATE LEGISLATURES & NAT'L CONF. OF STATE LEGISLATURES, PRINCIPLES OF A HIGH-QUALITY STATE REVENUE SYSTEM 1, 14–15 (4th ed. 2007) https://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx [https://perma.cc/3YVN-MJ2H] [hereinafter HIGH-QUALITY STATE REVENUE SYSTEM] (discussing the reasons states need to maintain high-quality state revenue systems, which requires, amongst other things, regular consideration of the costs and benefits of any tax incentive program). Thirty-four states and the District of Columbia have laws requiring regular evaluation of tax incentives, but these laws do not cover all types of tax incentives, nor do they guarantee that states use the analysis to inform their policy decisions. *See* PEW CHARITABLE TRS., HOW STATES ARE IMPROVING TAX INCENTIVES FOR JOBS AND GROWTH: A NATIONAL ASSESSMENT OF EVALUATION PRACTICES 3–4, 7 (2017) (discussing the increasing number of states who have enacted laws requiring regular evaluation of tax incentives but noting that in many of those states, evaluations may be sporadic or fail to provide a picture of an incentive's economic impact). *Compare* ARIZ. REV. STAT. ANN. § 43-221 (2020) (providing for the establishment of a joint legislative committee to review individual and corporate income tax credits), *with* WASH. REV. CODE §§ 43.136.045(1), 43.136.055(1)(j) (2020) (providing for the review of tax preferences—meaning any exemption, exclusion or deduction from the state tax base, state tax credit, deferrals, and

evaluate program features by asking several questions either before its adoption or even after its effective date.[214]

First, states should determine how they will assess the program's performance.[215] Section A of this Part discusses the criteria by which states could measure success.[216] Second, states should ask whether they can establish processes to monitor and evaluate outcomes.[217] Section B of this Part examines the aspects of the provision's design necessary to implement these processes.[218] Third, states should ask whether the program generally represents sound policy and examine strategies to address any shortcomings.[219] Section C of this Part considers issues of efficiency and equity.[220]

A. Measuring Performance

Evaluating tax expenditures begins with measuring their economic incidence—the extent to which affected parties are in a better position owing to

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preferential rate—at least once every ten years, in order to evaluate, amongst other things, the tax preference's economic impact).

[214] *See* STEUERLE, *supra* note 1, at 198 (explaining that the IRS does not collect nor analyze data measuring the outcomes of federal tax expenditures generally); Neumark & Simpson, *supra* note 19, at 1279 (arguing that not enough is known about the effects of place-based policies from currently available empirical evidence); *infra* notes 215–220 and accompanying text (summarizing the three key questions state lawmakers should ask before adopting federal place-based investment tax incentives); *see, e.g.*, Cummings, *supra* note 177 (noting the absence of official measures tracking the amount of capital gains escaping taxation through the Opportunity Zone investment tax incentive); *c.f.* U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-208G, DESIGNING EVALUATIONS 4–5 (2012) [hereinafter GAO-12-208G] (explaining that the information gleaned from well-designed evaluations of government programs can assist policymakers in making resource allocation decisions and guide any revisions to program design). Only states with fixed-date conformity can evaluate federal provisions prior to their inclusion in state tax law. *See* Mason, *supra* note 9, at 1276–77 (explaining the implications of dynamic conformity with federal tax law).

[215] *See* BODDUPALLI ET AL., *supra* note 171, at 3 (noting that federal tax expenditure programs represent a significant percentage of state tax expenditure budgets); STEUERLE, *supra* note 1, at 198 (discussing how the federal government has yet to institute systems and processes to measure program outcomes); *see, e.g.*, *supra* notes 115–122 and accompanying text (noting that without the ability to study a counterfactual, researchers cannot definitively attribute any statistical improvements in the well-being of community residents to the existence of a place-based policy).

[216] *See infra* notes 221–235 and accompanying text (arguing that states should mandate reporting requirements in order to assess the performance a federal place-based investment tax incentive).

[217] *See, e.g.*, Easton, *supra* note 145, at 11 (discussing the lack of longitudinal data that policymakers need to understand the effects of gentrification, if any); *supra* notes 108–116 and accompanying text (describing how the IRS does not track to what extent benefits from federal place-based investment tax incentives ultimately accrue to the populations the program targets).

[218] *See infra* notes 236–253 and accompanying text (arguing that states should administer federal place-based investment tax incentives in a way that facilitates evaluation of program outcomes).

[219] *See* HIGH-QUALITY STATE REVENUE SYSTEM, *supra* note 213, at 10, 12 (examining issues of equity and efficiency in a tax policy context).

[220] *See infra* notes 254–264 and accompanying text (discussing ways in which states could better ensure that implementing federal place-based investment tax incentives does not violate good tax policy principles of efficiency and equity).

the preferential tax treatment of certain behaviors or activities.[221] By contrast, parties enjoying statutory or technical incidence are more simply those who see a reduction in their tax liability as a direct result of a law's provisions.[222] States must be able to identify the economic incidence of a federal place-based investment tax incentive or otherwise resist implementing the provision in their state tax codes.[223] Only by measuring the economic incidence of a federal tax expenditure will states know who benefits from its adoption and to what degree.[224] Although Treasury can identify those taxpayers who are better off in terms of dollars saved on their tax liabilities, the IRS does not, however, measure the economic incidence of these provisions.[225] Before states conform to a federal provision offering place-based investment tax incentives, they should be ready to fill this gap.[226]

First, certain tax incentives like the New Markets Tax Credit (NMTC) and the Opportunity Zone provision contained within the Tax Cuts and Jobs Act of 2017 (TCJA) require taxpayer investments to pass through an intermediary entity before distribution to local businesses.[227] In this instance, states should

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[221] Linda Sugin, *Tax Expenditures, Reform, and Distributive Justice*, 3 COLUM. J. TAX L. 1, 19 (2011).

[222] *Id.*

[223] *See id.* at 23 (arguing that governments should not adopt tax expenditures when decisionmakers lack the ability to discern their economic incidence); *supra* notes 106–150 and accompanying text (discussing the lack of evidence showing that federal place-based investment tax incentives have a marked improvement on the lives of community residents). Charitable donation deductions are another example in which the difference between statutory and economic incidence is evident. Layser, *supra* note 52, at 413. Taxpayers who donate to a charity claim a deduction on their tax returns and thus benefit from its statutory incidence. *Id.* Charities, however, benefit from its economic incidence when donors decide to make higher contributions as a result of the deduction. *Id.*

[224] *See* Sugin, *supra* note 221, at 23 (arguing that if it were impossible to measure a tax provision's economic incidence, then policymakers should refrain from adopting that provision).

[225] JOINT COMM. ON TAX'N, JCS-7-93, METHODOLOGY AND ISSUES IN MEASURING CHANGES IN THE DISTRIBUTION OF TAX BURDENS 2–3 (Comm. Print 1993) [hereinafter JCS-7-93].

[226] *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-21-30, OPPORTUNITY ZONES: IMPROVED OVERSIGHT NEEDED TO EVALUATE TAX EXPENDITURE PERFORMANCE 15–19 (2020) (finding scant data available to evaluate the outcomes from the Opportunity Zone program and a lack of statutory authority to any federal agency to collect and evaluate such information for the purposes of reporting on the program's performance); Burge, *supra* note 109, at 95 (arguing that the majority of the LIHTC program costs do not reach its intended recipients in the form of rent savings); Hula & Jordan, *supra* note 22, at 26 (noting that the Service does not inquire as to whether the NMTC actually improves the lives of residents in targeted communities); Sugin, *supra* note 221, at 23 (maintaining that policymakers should not implement tax provisions without an accurate accounting of their economic incidence); *see, e.g.*, DELUCA ET AL., *supra* note 116, at 1 (discussing the NMTC and noting that a program costing $5 billion per year with no systematic evaluation of outcome should give Congress cause for concern). *See generally supra* notes 106–125 (discussing the mixed results from studies on the economic effects of federal place-based investment tax incentives).

[227] *See* I.R.C. §§ 45D(a)(1), 1400Z-2(a)(1)(A) (providing for tax benefits when investing in qualified CDEs in the case of the NMTC and in QOFs in the case of the Opportunity Zone program); *see also supra*-notes 74–101 and accompanying text (discussing the operational rules for the NMTC and the Opportunity Zone tax incentives).

call for these entities to report the fees and interest rates charged to investors and local businesses.[228] Second, in the case of provisions like the Low-Income Housing Tax Credit (LIHTC), the intermediary certifies the total cost of a project, and this cost may represent payments to multiple subcontractors.[229] Because the size of the tax benefit is proportional to total certified costs, states should require these intermediaries to document a breakdown of costs.[230] Third, when intermediaries choose which local businesses to subsidize with taxpayer-funded capital, they should collect and report key metrics to states.[231] Examples include hiring numbers and wages of low-income residents in the targeted area, and ultimately, whether these businesses succeed or fail.[232] Fourth, states should require intermediaries to disclose the location and type of projects subsidized in order to understand how a tax expenditure program impacts communities.[233] In the case of residential housing developments, measuring econom-

[228] *See* GAO-14-500, *supra* note 113, at 16 (remarking on the lack of reporting requirements required from CDEs); Lester et al., *supra* note 85, at 224 (noting that QOFs self-certify by filling out and filing an IRS form with their tax return); Sugin, *supra* note 221, at 23 (calling on lawmakers to avoid adopting a tax incentive when they cannot assess its economic incidence). For example, although the Treasury requires CDEs to disclose transaction costs, fees, and compensation to the local businesses they are financing, it does not collect, nor report on, the information contained in those disclosures. GAO-14-500, *supra* note 113, at 16. However, the more CDEs profit, the less likely that low-income communities benefit from the tax incentive program. *Id.* at 15–16.

[229] *See* I.R.C. § 42(g) (providing that the LIHTC program awards credits based on a percentage of the qualified basis of each qualified low-income building); GAO-18-637, *supra* note 7, at 45 (finding that state agencies charged with allocating tax credits to projects rely on final developer cost certifications, and few require additional contractor-level breakdown of project costs).

[230] *See* GAO-18-637, *supra* note 7, at 65 (concluding that Treasury's cost-certification mandates do not sufficiently address the risk of fraud when contractors misrepresent project costs); Sugin, *supra* note 221, at 24 (arguing that if policymakers wish for a tax incentive to benefit certain people, they should know whether the incentive's design misdirects the benefits to unintended third parties). The LIHTC does not require developers to report a breakdown of construction costs by individual contractor, and thus also invites developers to inflate costs in order to fraudulently obtain additional tax credits. GAO-18-637, *supra* note 7, at 65.

[231] *See* GAO-14-500, *supra* note 113, at 22–23 (noting that when NMTC-subsidized projects fail, it minimizes the social and economic benefits of the program to communities, and calls on the CDFI to better gather data on distressed projects); Mason, *supra* note 9, at 1303–04 (arguing that states, being closer to targeted communities and stakeholders, are in a better position to address the information asymmetries that make it difficult for governments to ensure tax incentives are having their intended effects).

[232] *See* GAO-14-500, *supra* note 113, at 22–24 (noting that current NMTC reporting requirements do not fully capture each CDE's project failure rate even as CDEs with financially distressed assets reapply for additional NMTC allocations); DELUCA ET AL., *supra* note 116, at 13 (recommending that Congress implement procedures to measure the employment and wages of low-income residents hired directly by NMTC-subsidized projects located in low-income communities).

[233] *Cf.* CONG. RESEARCH SERV., R45152, TAX INCENTIVES OF OPPORTUNITY ZONES: IN BRIEF 12 (2019) (criticizing the Opportunity Zone program for its lack of disclosures as opposed to those required for NMTC-funded projects). Although the NMTC requires CDEs to report this information, the Opportunity Zone scheme imposes no such requirement on QOFs. *Id.* For instance, less than half of qualified Opportunity Zone investment funds focus exclusively on a single state or city, with the remainder investing in cities across the country. *See generally* NAT'L COUNCIL OF STATE HOUS.

ic incidence also requires demographic data of those who ultimately move into new units.[234] For, if indeed incentives like the LIHTC concentrate poverty in minority communities, then states should not only refrain from providing further subsidies in the form of state tax credits, but should also include racial and socioeconomic integration as one key criterion in their allocation decisions.[235]

B. Managing Assessment

Tax incidence data from intermediary entities would allow state legislatures to know whether the structure of the federal place-based investment tax incentive diverts the benefits of the program away from low-income communities.[236] Whether the program's intended beneficiaries experience economic incidence is a separate and more complicated question.[237] To answer this question, states would need to monitor the economic well-being of low-income residents over time to see whether these metrics improve as a result of place-

AGENCIES, OPPORTUNITY ZONE FUND DIRECTORY (2019) (listing Opportunity Zone funds registered as of December 2019). This means, for example, that Louisiana residents can benefit from reductions in their state tax liability for contributing capital gains to Opportunity Zone funds investing in Texas, Massachusetts, or other states. *See* I.R.C. § 1400Z-2(a)–(c) (lacking any requirement that taxpayers choose funds that invest in their resident states); LA. STAT. ANN. § 47:293 (2020) (conforming to the state's definition of adjusted gross income to that which is reportable on an individual's federal income tax return).

[234] *See* Callison, *supra* note 131, at 245 (showing that 43% of LIHTC units are located in poor minority communities, a number rising to 60% in urban areas); Orfield, *supra* note 5, at 135–36 (conceding that if poor white families were moving into newly constructed LIHTC units, then the LIHTC's effect in racially segregating communities would be overstated, but noting that Treasury does not collect data on the race of residents in LIHTC-subsidized housing); *supra* notes 126–133 and accompanying text (discussing the possibility that by way of design, the LIHTC harms the very individuals it aims to help).

[235] *See* Layser, *supra* note 23, at 948–49 (explaining that the combination of two factors result in the concentration of LIHTC development in poor communities: first, the LIHTC subsidizes a greater portion of projects located in areas with a high poverty rate or low median income, and second, the federal government limits the amount of tax credits it awards to each state); Layser, *supra* note 17, at 754–55 (noting that not only do poor communities exhibit dismal outcomes across economic and social indicators, including high rates of crime and unemployment, but also that conditions of concentrated poverty in early childhood reduce the cognitive function and earning power of those who come of age in these neighborhoods and their children—irrespective of whether they later move to mixed-income communities); Orfield, *supra* note 5, at 151–55 (arguing that FHA duties require allocation decisions to affirmatively further racial and socio-economic integration). In 2004, the NAACP sued New Jersey state officials for disproportionately awarding LIHTC credits to developments in minority neighborhoods in violation of the FHA. *In re* Adoption of the 2003 Low-Income Hous. Tax Credit Qualification Plan, 848 A.2d 1, 9–10 (N.J. Super. Ct. App. Div. 2004). *See generally* Orfield, *supra* note 5, at 138–44 (discussing the case and its broader implications on the state's role in furthering racial segregation through the LIHTC program).

[236] *See* Sugin, *supra* note 221, at 19 (explaining the concept of economic incidence); *supra* notes 221–235 and accompanying text (discussing measuring economic incidence by way of data collected from intermediaries who influence the size of subsidized investments and to whom it flows).

[237] Sugin, *supra* note 221, at 23.

based policies.[238] Gathering longitudinal data is essential not only to assess performance but also to ensure any improvements in observed metrics are not the result of displacing existing residents.[239] States often have better access to the relevant metrics, such as rates of employment and crime, levels of household income and educational attainment, as well as racial diversity.[240] States may, therefore, be in a better position than the federal government to analyze the effects of place-based tax expenditures.[241] Indeed, that place-based policies are location-specific inherently limits states' ability to use studies of economic outcomes from tax incentives applied elsewhere to make decisions about the intervention's fit within their borders.[242]

Seeking to causally link outcomes to policy interventions poses, however, several challenges.[243] At the onset, states should ensure that selected areas map closely to the geographic delineations in existing data sets.[244] Policymakers should also qualify areas for the tax benefit using a methodology that would permit later study of counterfactuals.[245] That is, allowing researchers to com-

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[238] *See* Easton, *supra* note 145, at 11 (noting that without longitudinal data, it is impossible to truly measure the effects of changing neighborhoods on residents); *supra* notes 134–150 and accompanying text (discussing how the true effects of place-based policies remain unknown without an understanding of the effects of gentrification).

[239] *See* Easton, *supra* note 145, at 11 (noting that without longitudinal data, the question as to whether gentrification negatively impacts community residents remains unanswered); *supra* notes 134–150 and accompanying text (discussing how and why policymakers are unable to determine whether federal place-based investment tax incentives encourage gentrification or whether gentrification is detrimental to community residents).

[240] *See* Mason, *supra* note 9, at 1303–04 (noting that information asymmetries are smaller between states and their residents than between the federal government and citizens because states can more easily acquire information about their residents).

[241] *See* JCS-7-93, *supra* note 225, at 2–3 (explaining that although data collection and analysis is necessary for a comprehensive understanding of a tax incentive's impact on the economic well-being of targeted groups, the abilities required to undertake such a task are outside the Joint Committee on Taxation's area of competence).

[242] *See* Neumark & Simpson, *supra* note 19, at 1280 (questioning how applicable the conclusions from studies on place-based policies in one area are to another area, considering the geographical differences of the locales in question).

[243] *See id.* at 1221 (noting that understanding the causal effects of place-based policies suffer from the usual limitations of econometric research, as well as some challenges specific to the type of analysis involved); *supra* notes 106–150 and accompanying text (discussing the issues that inhibit a comprehensive understanding of the true effects of place-based policies).

[244] *See* Neumark & Simpson, *supra* note 19, at 1222 (describing this unique challenge in studying outcomes of place-based policies). This issue first appeared in the study of enterprise zones. *Id.* One California place-based incentive program, for example, defined the boundaries for qualifying zones using street addresses, but data from the U.S. Census Bureau reflected metrics based on the contours of each zip code. *Id.* Although researchers were able to approximate performance within a zone, the state could have helped researchers minimize measurement errors had it prevented a mismatch in data sets. *Id.*

[245] *See id.* at 1237 (describing one study in which researchers were able to study an approximate counterfactual because targeted tracts automatically qualified for the incentive based on poverty rates).

pare places similar in almost all respects except where some selected areas would have benefited from the tax expenditure.[246] One way to accomplish this goal chooses areas purely on a mechanical and non-competitive basis, based on a cutoff poverty rate from census data.[247] Unselected census tracts nearby are more likely to resemble those areas chosen to participate in the program, allowing researchers to better attribute any improvements in economic well-being to the incentive itself.[248]

After collecting the data, its continuous monitoring and analysis should not fall solely on the state's tax collection and enforcement agency.[249] Instead, the task of evaluation should also fall to the agency whose purview has a logical relationship to the metric states choose to assess performance.[250] For example, if Massachusetts wished to evaluate a place-based tax expenditure using employment rates, then the Economic Research Department at Massachusetts's Department of Unemployment Assistance would likely have access to the necessary information and expertise to provide a more comprehensive analysis.[251] Alternatively, states could charge nonpartisan offices regularly

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[246] *See* Clougherty, *supra* note 119, at 287, 291 (explaining the concept of counterfactuals); Hula & Jordan, *supra* note 22, at 25 (discussing studies on the NMTC and concluding that without the ability to study counterfactuals, researchers are impaired in their capacity to definitively attribute economic outcomes to the policy intervention); *see also supra* notes 117–121 and accompanying text (noting that without a counterfactual, policymakers cannot definitively rule out crowd-out effects).

[247] *Compare* Freedman, *supra* note 75, at 1001–02 (explaining the design of a study allowing the researcher to examine approximate counterfactuals because NMTC allocations are based on threshold poverty rates and median family income), *with* Lester et al., *supra* note 85, at 223 (noting that although census tracts qualifying for Opportunity Zone investments must be below certain income thresholds, governors employ a range of factors in selecting areas for federal approval).

[248] *See* Freedman, *supra* note 75, at 1001–02 (describing the program design of the NMTC which allows for the study of an approximate counterfactual). In the case of Opportunity Zones, state governors selected areas for a variety of reasons, even if poverty rates in those tracts are above the threshold under the tax provision. HILARY GELFOND & ADAM LOONEY, BROOKINGS INST., LEARNING FROM OPPORTUNITY ZONES: HOW TO IMPROVE PLACE-BASED POLICIES 10 (2018). A more mechanical approach also decreases the likelihood of selection bias skewing study results. *See* Neumark & Simpson, *supra* note 19, at 1237 (explaining that the mechanical nature by which Texas selected census blocks for a place-based intervention made it possible for researchers to construct an approximate counterfactual); *see also* Freedman, *supra* note 75, at 1001–02 (outlining the study design for the Texas study).

[249] *See* PEW CHARITABLE TRS., *supra* note 213, at 12 (recommending that the evaluating office should have the capacity to make actionable policy recommendations, the relevant experience in evaluating government programs, and a neutral, nonpartisan viewpoint); U.S. GOV'T ACCOUNTABILITY OFF., GAO-13-167SP, TAX EXPENDITURES: BACKGROUND AND EVALUATION CRITERIA AND QUESTIONS 29 (2012) [hereinafter GAO-13-167SP] (noting that the IRS may not be the most appropriate agency to evaluate tax incentives seeking to achieve outcomes outside its area of expertise).

[250] *See* GAO-13-167SP, *supra* note 249, at 29 (recommending, at the federal level, a strategy of sharing the evaluation of tax incentives with related agencies).

[251] *See Labor Market Information*, MASS. DEP'T OF UNEMPLOYMENT ASSISTANCE, ECON. RSCH. DEP'T, https://www.mass.gov/orgs/labor-market-information [https://perma.cc/L4U5-3LCQ] (describing the purview of the Economic Research Department within the Department of Unemployment Assistance).

conducting legislative audits with assessing the incentive, as they do in states with robust evaluation practices.[252] Before adopting a federal place-based investment tax expenditure, states should therefore consider whether these agencies have the administrative capacities and the skill sets to conduct such assessments.[253]

C. Considering Efficiency and Equity

Because federal place-based investment tax incentives yield uncertain outcomes, states should consider whether the provision's design seeks efficiency and curbs the revenue that states would stand to lose.[254] For instance, if the provision capped the aggregate amount taxpayers can claim or limited taxpayer eligibility, its design would constrain any resulting revenue loss.[255] Indeed, Congress has restricted the amount of NMTC allocations that the CDFI Fund could issue annually to CDEs.[256] By contrast, when investing in a fund qualifying for Opportunity Zone treatment, taxpayers can defer or ultimately exclude an unlimited amount of capital gains.[257] Relatedly, states should also refrain from adopting any place-based provision before Treasury releases final regulations so they can fully account for the law's budgetary impact.[258]

Furthermore, states should ask whether federal place-based investment tax incentives treat taxpayers equitably or whether benefits accrue primarily to the wealthy.[259] High-income taxpayers generally have the most to gain from

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[252] *See* PEW CHARITABLE TRS., *supra* note 213, at 12 (describing best practices for states when selecting the agency tasked with assessing program outcomes).

[253] *See id.* (recommending that in order to produce actionable analysis for policymakers, states should give careful consideration to the agency tasked with evaluating tax incentives).

[254] *See* GAO-13-167SP, *supra* note 249, at 11–12 (recommending that policymakers evaluate tax expenditures by weighing their costs against the benefit they provide to society); Layser, *supra* note 17, at 789–97 (noting the dearth of empirical support for the belief that place-based tax incentives benefit low-income communities and arguing that governments should eschew such interventions); *see also supra* notes 102–150 and accompanying text (assessing the outcomes of federal place-based policies and showing that results are mediocre at best). Tax expenditure programs are "efficient" when the benefits gained from the programs exceed their costs. GAO-13-167SP, *supra* note 249, at 11.

[255] *See* GAO-13-167SP, *supra* note 249, at 27 (discussing the options that could limit revenue loss as a result of a tax expenditure).

[256] Lester et al., *supra* note 85, at 227.

[257] *Id.*; *see* I.R.C. § 1400Z-2 (providing no limitations on the amount of capital gains taxpayers could exclude or defer when investing in an Opportunity Zone fund); Treas. Reg. § 1.1400Z2 (same). A floor could also serve to limit revenue loss by providing preferential tax treatment to taxpayers who invest only above specified limits. GAO-13-167SP, *supra* note 249, at 28.

[258] *See* Mason, *supra* note 9, at 1306–09 (describing revenue disruptions at the state level resulting from new or amended federal tax expenditure provisions); *see also supra* notes 176–181 and accompanying text (arguing that because of Treasury's actions, states do not have a clear understanding of the impact of the TCJA Opportunity Zone provision on state budgets).

[259] *See, e.g.*, Lowry & Marples, *supra* note 122, at 607–08 (explaining that capital owners benefit most from investment incentives and credits, like the NMTC and Opportunity Zone programs, rather

tax expenditures.[260] For federal place-based investment tax incentives, it is unclear whether better economic outcomes for low-income households offset the tax revenue relinquished to provide favorable tax treatment to wealthy individuals.[261] States risk even higher chances of inequitable outcomes when incentives reduce capital gains taxation because capital holdings are concentrated in the hands of the wealthiest households.[262] Mitigating measures, however, could include a phase-out of state tax benefits as incomes increase or the elimination of benefits for income above a certain limit.[263] Therefore, states should be wary of federal place-based investment tax incentives without such provisions or include such measures themselves to limit the inequitable distribution of benefits.[264]

Looking forward, the pace at which the federal government uses tax expenditures to further economic and social policy goals is unlikely to abate.[265] State officials have, however, begun questioning the wisdom of reflexively adopting these provisions.[266] In California, the state legislature allowed a bill adopting TCJA Opportunity Zone provisions to lapse, despite gubernatorial

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than targeted low-income communities); *see also supra* notes 122–125 and accompanying text (discussing the effects of place-based incentives on vertical equity).

[260] Schizer, *supra* note 8, at 315–18. For example, in 2011, the top 20% of earners claimed 80% of the tax benefit from itemized deductions and over 60% of the benefit from exclusions. *Id.* at 315.

[261] *See* Neumark & Simpson, *supra* note 19, at 1279 (arguing that for place-based policies, studies thus far have not yielded conclusive evidence of their ability to achieve stated goals); *supra* notes 102–150 and accompanying text (asserting that it is unclear whether federal place-based investment tax incentives have resulted in better economic and social outcomes for communities).

[262] *See* STEUERLE, *supra* note 1, at 248–49 (discussing how reductions in capital gains benefit primarily the highest income brackets).

[263] *See* Schizer, *supra* note 8, at 333 (discussing measures to limit tax expenditures that undermine vertical equity).

[264] *See generally* GAO-13-167SP, *supra* note 249, at 15 (recommending that policymakers consider issues of equity when evaluating a tax expenditure).

[265] *See* STEUERLE, *supra* note 1, at 5 (discussing the preference of both political parties in the United States for spending through the tax code); Mason, *supra* note 9, at 1271 (arguing that because Congress is inclined to use federal tax law to regulate taxpayer behavior, the impact of federal tax law conformity on state regulatory autonomy will likely grow).

[266] *See, e.g.*, John Herzfeld, *Maryland House Backs Decoupling from Opportunity Zone Law*, BLOOMBERG L. NEWS (Mar. 12, 2020), https://www.bloomberglaw.com/product/tax/document/XATS05U8000000?bna_news_filter=daily-tax-report-state&jcsearch=BNA%252000000170d07ad3adab7fd67e7dea0001#jcite [https://perma.cc/NG33-QZF4] (reporting on the Maryland House of Delegates and their passing of legislation to decouple from the TCJA Opportunity Zone program); *The 2019-20 May Revision: Opportunity Zones*, CAL. LEGISLATURE'S NONPARTISAN FISCAL & POL'Y ADVISOR, LEGISLATIVE ANALYST'S OFF. (May 11, 2019), https://lao.ca.gov/Publications/Report/4038 [https://perma.cc/ZDT4-8ETN] [hereinafter LEGISLATIVE ANALYST'S OFF.] (recommending that the California state legislature reject conformity with the TCJA Opportunity Zone initiative). Federal officials, too, have called for reform with President Joseph Biden criticizing the scheme as having "failed to deliver" and proposing a review to ensure it clearly benefits low-income communities. *The Biden Plan to Build Back Better by Advancing Racial Equity Across the American Economy*, BIDEN HARRIS DEMOCRATS, https://joebiden.com/racial-economic-equity [https://perma.cc/W3RQ-KZR8].

support for the initiative.[267] Likewise, in Maryland, a bill is winding its way through the State Senate and House of Delegates, seeking to make Maryland the first dynamically conforming state to decouple from Opportunity Zone provisions.[268] Whether Maryland and other states ultimately reject this and future federal place-based investment tax incentives remains uncertain.[269] Sizeable budget shortfalls stemming from the coronavirus pandemic are, however,

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[267] Mahoney, *supra* note 157; *see also* S.B. 315, 2019–2020 Reg. Sess. (Cal. 2019) (proposing to conform California tax law to Code provisions allowing for preferential tax treatment of gains invested in Opportunity Zones in the state). California Governor Gavin Newsom advocated bringing the state in closer alignment with the federal tax system as part of his 2019–2020 "California for All" state budget proposal. CAL. OFF. OF THE GOVERNOR, GOVERNOR'S BUDGET SUMMARY: 2019–2020, at 94 (2019). Without legislation to bring California's tax code in line with federal incentives, state residents who invest in Opportunity Zones will see their capital gains taxed at a little over 12%, leading some analysts to believe that the state tax would cancel out any reductions in federal tax liabilities. *See 2019 540 Forms and Instructions Personal Income Tax Booklet*, CAL. FRANCHISE TAX BD., https://www.ftb.ca.gov/forms/2019/2019-540-booklet.html#2019-California-Tax-Rate-Schedules [https://perma.cc/Q4CV-P453] (providing tax rates on personal income for California residents); *Capital Gains and Losses, Personal Income Types*, CAL. FRANCHISE TAX BD., https://www.ftb.ca.gov/file/personal/income-types/capital-gains-and-losses.html-[https://perma.cc/L4MT-FRSM] (providing that California taxes capital gains as ordinary income); *see, e.g.*, Joseph Pimentel, *Opportunity Zones Could Flop in California, Officials Warn*, BISNOW (Aug. 15, 2019), https://www.bisnow.com/los-angeles/news/opportunity-zones/strong-unlikelihood-california-will-conform-to-opportunity-zone-tax-advantages-100351 [https://perma.cc/V9FW-H9H7] (reporting on State Treasurer Fiona Ma's efforts to bring California in conformity with the Opportunity Zone scheme so that the state capital gains rate would not offset investors' potential savings in their federal taxes). California's Legislative Analyst's Office (LAO) considered results from the state's past experience with the NMTC from 2003 to 2014 and found that the tax expenditure had little to no positive impact on the income of low-income residents. LEGISLATIVE ANALYST'S OFF., *supra* note 266. By examining the state's current tax structure, the LAO concluded that any efforts to use Opportunity Zone incentives to fund affordable housing would further concentrate low-income households to high poverty neighborhoods. *Id.* It also found evidence suggesting that the Opportunity Zone program will ultimately be a windfall to investors. *Id.* The LAO further noted that the tax benefit introduced administrative complexities, and the state lacked the necessary governance structure to provide oversight and ensure compliance. *Id.*

[268] *See* FED'N OF TAX ADM'RS, *supra* note 12, at 1 (listing Maryland as a dynamically conforming state, that is a state where the state tax code references the most current version of the IRC); Herzfeld, *supra* note 266 (reporting on the bill's passage in Maryland's House of Delegates and noting that the measure now goes to the state Senate); Lauren Loricchio, *Maryland Could Decouple from Federal Opportunity Zone Program*, TAX NOTES (Mar. 12, 2020) https://www.taxnotes.com/tax-notes-today-state/tax-preference-items-and-incentives/maryland-could-decouple-federal-opportunity-zone-program/2020/03/12/2c8lf [https://perma.cc/2RAW-DDUU] (remarking that Maryland would be one of the first states to decouple from the TCJA Opportunity Zone); *see also* S.B. 263, 2020 Leg., 441st Sess. (Md. 2020) (proposing that Maryland taxpayers must add back to their state tax liability any capital gains excluded under the federal Opportunity Zone scheme); H.B. 224, 2020 Leg., 441st Sess. (Md. 2020) (same).

[269] *Compare* Maria Koklanaris, LAW 360 TAX AUTH., *Opportunity Zone Investors May See More State Tax Windfalls* (May 1, 2019) https://www.law360.com/articles/1154835 [https://perma.cc/Q43B-RP4G] (predicting that states will conform to the TCJA Opportunity Zone tax incentive), *with* Lorrichio, *supra* note 268 (reporting on the Maryland legislature's efforts in March of 2020 to reject conformity), *and* Mahoney, *supra* note 157 (reporting on the California legislature's decision in September 2019 to allow the governor's proposal to bring state tax law in conformity with the TCJA Opportunity Zone program to lapse).

in the offing, as is the pressing need to fund local recovery efforts.[270] By implementing this framework for rigorous program evaluation, states need not reject tax base conformity and all its attending benefits to better ensure these federal place-based programs bring economic benefits to communities in crisis.[271]

CONCLUSION

Federal investment tax incentives are here to stay. As with all tax expenditures adopted at the federal level, states risk seeing their tax revenue shrink as a result of these tax breaks. States must therefore choose to either subscribe to the policy goals behind such expenditures or sacrifice the administrative convenience that comes with conforming to federal tax law. This Note synthesizes the scholarship on this issue and focuses the analysis on federal place-based investment tax incentives. It argues that past outcomes from these tax expenditures are equivocal at best, and they cause states fiscal uncertainty while constraining their autonomy to drive community development tax policies. Yet, programs offering these incentives remain popular with Congress, and decoupling from federal law requires tradeoffs states may not be prepared to make. This Note, therefore, urges state officials to evaluate federal place-based investment tax incentives prior to adoption and offers a framework to assist their assessment. The framework first examines the law and asks whether its provisions permit states to gather the information necessary to measure the program's performance. It then looks to states and asks whether they have the administrative capacity to implement the processes required to monitor and evaluate outcomes effectively. Lastly, it considers whether the intervention follows principles of sound tax policy—whether it generates net benefits as a whole and distributes those benefits equitably.

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[270] *See* NAT'L ASS'N OF STATE BUDGET OFFICERS, FISCAL SURVEY OF STATES: FALL 2020, at 52 (2020) (showing that for fiscal year 2020, states saw a $12.3 billion decline in tax collection and project an decline of $30.9 billion in fiscal year 2021 while, prior to the COVID-19 crisis, the state projected revenue growth of about 3% for both years); McKenzie Cantlon, *Rainy Days Are Here: States Tap Reserve Funds to Plug Budget Holes*, NAT. CONF. OF STATE LEGISLATURES (Jan. 11, 2021), https://www.ncsl.org/research/fiscal-policy/rainy-days-are-here-states-tap-reserve-funds-to-plug-budget-holes.aspx [https://perma.cc/N69B-RVPX] (discussing how state legislatures have resorted to tapping budgetary reserves when pandemic-related shutdowns reduced tax revenue. while the resulting unemployment increased expenditures on social assistance programs); Anshu Siripurapu & Jonathan Masters, *How COVID-19 Is Harming State and City Budgets*, COUNCIL ON FOREIGN RELS. (Jan. 12, 2021), https://www.cfr.org/backgrounder/how-covid-19-harming-state-and-city-budgets [https://perrma.cc/9L4F-UCXL] (asserting that the fiscal shock from the COVID-19 pandemic will rival that of the 2007-2009 Great Recession).

[271] *See supra* notes 212–264 and accompanying text (proposing a framework for states to evaluate federal place-based investment tax incentives); *c.f.* GAO-12-208G, *supra* note 214, at 4–5 (explaining that comprehensive evaluation is the necessary first step to designing better public programs).