Measuring Opportunity Zone Success
Scott Eastman
Federal Research Manager

Key Findings

• The Tax Cuts and Jobs Act (TCJA) established the Opportunity Zones program to increase investment in economically distressed communities. This place-based incentive program provides capital gains tax incentives for those who reinvest capital gains into qualified opportunity funds (QOF).

• To establish that Opportunity Zones are effective, evaluators would need to show that opportunity zones created economic benefits, such as increased employment opportunities for residents within distressed communities over the long term, that would not have occurred without the program.

• The opportunity zone designation process generally allowed for no more than 25 percent of a state's low-income census tracts to be designated, leaving a set of low-income census tracts that were eligible to be opportunity zones, but not chosen. These census tracts provide program evaluators with a set of comparison groups to assess the impact of opportunity zones.

• The Department of the Treasury currently cannot connect opportunity zone data—such as the number of QOFs and amounts invested by QOFs and qualifying opportunity zone businesses—to specific census tracts. Tying data reported by QOF investors to specific census tracts would allow evaluators to better measure the effects of opportunity zones.
Introduction

The Tax Cuts and Jobs Act (TCJA) established the Opportunity Zones program to increase investment in economically distressed communities. This place-based incentive program provides several capital gains tax incentives for investors who reinvest capital gains in qualified opportunity funds, which then invest these resources in mostly low-income census tracts designated as opportunity zones.

The evidence on place-based incentive programs is mixed. Some research suggests these programs can be counterproductive for economically distressed communities by attracting capital and labor that increases employment competition and prices, which could lead to displacement of economically distressed residents. Proponents argue Opportunity Zones could lead to better outcomes because the program focuses on development investment at a larger scale than specific projects, allowing investors to pool resources, invest in multiple projects, and minimize risk. Despite mixed evidence, policymakers at the federal level hope opportunity zones will revive economically distressed communities.

This report discusses how program evaluators measure place-based incentive programs, focusing particularly on what makes a program “successful.” It then discusses how opportunity zones can be measured against this benchmark, and suggests the Internal Revenue Service (IRS) should modify Form 8996—the form that opportunity zone investors will use to report their activities to the IRS—so that opportunity zone data on the number of QOFs, QOF investment, and qualifying business investment, can be tied to specific census tracts to help measure the program.

The Opportunity Zone Program

To qualify for opportunity zone tax benefits, investors must reinvest the proceeds from one or more capital gains in a Qualified Opportunity Fund (QOF), an investment vehicle that must hold 90 percent or more of its assets in qualified opportunity zone property.

An investor gains three tax benefits by reinvesting capital gains in a QOF. The first is temporary tax deferral on any capital gains reinvested in a QOF until the investment is sold or exchanged, or until December 31, 2026. The second benefit is a step-up in basis worth up to 15 percent of the value of an investor’s reinvested capital gains if the capital gains are held in a QOF for seven years, again before December 31, 2026. Step-up in basis allows taxpayers to exclude a portion of their reinvested gain from their taxable income, which lowers the taxpayers’ tax liability. The third benefit for QOF investors is that the basis of any investment held in a QOF for 10 years is increased to 100 percent of its fair market value on the date it is sold or exchanged. This means any capital gains that accrue within the QOF are completely excluded from taxation after 10 years.

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3 Qualified opportunity zone property includes qualified stock, a qualified partnership interest, and qualified business property. The TCJA places several requirements on each type of property that makes them qualified opportunity zone property. For more information see 26 USC § 1400Z-2 (d)(1-2).
4 For a more detailed explanation of opportunity zone tax incentives, see Scott Eastman and Nicole Kaeding, “Opportunity Zones: What We Know and What We Don’t.”
The Joint Committee on Taxation (JCT) estimates the Opportunity Zones program will cost $1.6 billion between 2018 and 2027. The program is estimated to decrease revenue between 2018 and 2025 but generate revenue in 2026 and 2027, as investors will no longer be able to defer taxes on the capital gains they reinvested in QOFs.\(^5\)

**TABLE 1.**

<table>
<thead>
<tr>
<th>Year</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opportunity Zone Cost (Billions of Dollars)</td>
<td>-1.2</td>
<td>-1.7</td>
<td>-1.6</td>
<td>-1.7</td>
<td>-1.6</td>
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<td>-1.6</td>
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</tr>
</tbody>
</table>

Source: Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, The 'Tax Cuts and Jobs Act.'"\(^5\)

The Goal of Opportunity Zones and the Importance of Measurement

While the United States has one of the world’s most productive economies, this productivity is concentrated in a few cities and regions. Policymakers are concerned about this uneven distribution and what it means for people outside of the country’s most productive areas.

In May 17, 2018 testimony before the Joint Economic Committee (JEC), U.S. Senator Cory Booker (D-NJ) spoke to these concerns:

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While some parts of the country have seen great economic gains in recent years, many communities have struggled, and the gains have been uneven. By many measures, the decade since the Great Recession has been the most geographically unequal economic recovery of the modern era: from 2010 to 2016, metropolitan areas with more than a million residents accounted for two-thirds of the growth in the country’s economic output, and almost three-quarters of net job creation nationwide. Many smaller metropolitan areas and rural areas have seen much slower growth, or declines, in output and employment. The economic pain has been especially acute in many smaller cities that were once powered by a strong manufacturing base, as well as in communities of color. All told, today, one in six, or 50 million people, live in economically distressed communities. These communities struggle with a lack of investment, business growth, and job growth, leaving millions of Americans unable to share in our national economic growth.\(^6\)
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Sen. Booker’s testimony was on the implementation of the Opportunity Zones program, a place-based incentive program that was established by the Tax Cuts and Jobs Act in 2017. The program passed by the TCJA was originally proposed in the Investing in Opportunity Act, which Sen. Booker co-sponsored with South Carolina Senator Tim Scott (R-SC), earlier in 2017.\(^7\)

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Like many other place-based incentive programs introduced in the past, the goal of opportunity zones is to revive economically distressed communities, in both rural and urban areas. In theory, tax incentives can attract investment to particular, economically distressed areas by reducing the cost of investment within those areas. By reducing investment costs, tax incentives compensate investors for factors like higher crime and reduced access to skilled labor and transportation that might make an economically distressed area less attractive for investment than other areas.\(^8\)

Research on the effectiveness of prior place-based incentive programs is mixed, and some suggest these programs can be counterproductive to helping distressed residents. For instance, a program's subsidies might displace residents if they support jobs that aren't suitable for the skills of current residents. If there is a skills mismatch, labor from outside of the distressed community would take those employment opportunities, instead of distressed zone residents. The inflow of capital and labor in response to tax incentives could also increase housing prices, which could be problematic for individuals with lower incomes.\(^9\)

Still, proponents point to differences in opportunity zones that could yield better outcomes. For instance, economists Jared Bernstein and Kevin Hassett argue opportunity zones are “a new approach to geographically targeted economic policy that could be far more effective than those tried in the past.” In contrast to previous programs which focused primarily on specific firms or projects, they note that opportunity zones focus on development at a scale larger than specific projects by allowing investors “to pool their resources and invest in numerous projects at any given time in a highly nimble fashion.” This ability to pool resources within a fund both minimizes the risk to particular investors and gives investors “the capacity to move a high volume of investments into depressed communities at relatively low cost to the Federal Government.”\(^10\)

To know whether opportunity zones offer a better approach for reviving economically distressed communities than prior place-based incentive programs, measuring the program’s effects will be crucial. Sen. Booker highlighted this importance in his testimony before JEC:

As we implement the Opportunity Zones program, we must take appropriate steps to ensure that its incentives support projects that benefit the residents of economically distressed communities, in line with the legislative intent. In particular, the Treasury Department should use its regulatory authority to ensure that Opportunity Funds realize their potential to transform communities and benefit local residents. With appropriate guardrails, the Treasury Department can ensure that Opportunity Fund investments are targeted to truly high-need communities and in projects that support inclusive economic development.\(^11\)

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\(^8\) Scott Eastman and Nicole Kaeding, “Opportunity Zones: What We Know and What We Don’t.”
\(^9\) Ibid.
\(^10\) Jared Bernstein and Kevin Hassett, “Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas.”
Senators Booker and Scott originally put reporting requirements in their *Investing in Opportunity Act*, which would have required the U.S. Treasury (Treasury) to submit an annual report to Congress on the program's outcomes—focusing on job creation, poverty reduction, and new business starts—beginning five years after the program's implementation. However, these reporting requirements were dropped when the program was included in the TCJA.\(^\text{12}\)

## Measuring Place-Based Incentive Programs and Defining Success

With any policy evaluation, the objective is to determine a policy's impact on the group of people it is trying to help. This means evaluators must assess to the best of their abilities what would have happened to this group if the policy had never been implemented. This requires program evaluators to find a similar *but non-treated* area to serve as a comparison group. Comparison groups should have characteristics similar to the areas impacted by the policy, before the policy was implemented. However, comparison groups should not be impacted by the policy after it takes effect. Otherwise, evaluators would not be able to isolate the effect of the program relative to the comparison group. Evaluators should also consider the method by which areas are selected for the program's benefits, because some areas may have characteristics that make them more likely to be chosen, introducing a selection bias.\(^\text{13}\)

After establishing valid comparison groups, evaluators can work to isolate the impact of the program. Since place-based incentive programs are generally geared toward helping residents of economically distressed communities, a successful program would create benefits for distressed zone residents over the long-term (i.e., after the program ends, not just while subsidies are in effect) which would not have occurred without the policy.\(^\text{14}\) These benefits might be new employment, new business formation, increased wages, lower unemployment, or other benefits, as compared to the evaluator's comparison group.\(^\text{15}\)

One caveat is that evaluators should try and ascertain whether a program created jobs *on net*, or whether it simply encouraged firms or investors to shift activity into the benefited area for a tax break. Positive employment outcomes might be viewed differently if those outcomes came at the expense of another area's employment. For instance, research studying the effect of the United Kingdom's Enterprise Zones program found between 50 percent and 80 percent of businesses simply relocated from other areas. This led the UK government to phase out this place-based incentive program.\(^\text{16}\)

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\(^{12}\) Scott Eastman and Nicole Kaeding, “Opportunity Zones: What We Know and What We Don’t.”


\(^{14}\) For instance, David Neumark and Helen Simpson argue, “A much stronger case would exist if some kinds of place-based policies helped to jump-start economic development in an area in a way that becomes self-sustaining – in the language of economics, by moving the area to a new equilibrium.” See “Place-Based Policies,” Handbook of Regional and Urban Economics, Volume 5B, 2015, https://www.socsci.uci.edu/~dneumark/1-s2.0-B9780444595317000181-main.pdf.

\(^{15}\) See section 5, “Evidence on impacts of policy interventions,” in Neumark and Simpson, “Place-Based Policies,” for a discussion of many different impact studies, with details on research design.

Evaluating Opportunity Zones

The Opportunity Zone designation process provides evaluators with a set of comparison groups. Generally, opportunity zones had to be in census tracts that qualified as low-income communities, defined as a tract with a poverty rate of at least 20 percent. Aside from a few exceptions, the number of census tracts in a state designated could not exceed 25 percent of the total number of low-income communities in the state.

The low-income census tracts that were eligible to be opportunity zones but not designated provide an appropriate comparison group. They were similar to opportunity zones before the program was started, but since these tracts did not receive the program’s tax benefits, evaluators can compare whether opportunity zone incentives actually impacted economic outcomes like employment or wages after the program began, relative to these census tracts. Opportunity zone measurement is also aided by the fact that the program’s boundaries are based on census tracts. This means evaluators can use readily available data broken down by census tract at the state level.

Ultimately, any place-based incentive program analysis will be imperfect. For instance, some opportunity zones would have to be excluded because they were not low-income communities. Another complication is that opportunity zones were picked by governors. This means the opportunity zone selection process was impacted by the biases of the governors selecting the zones. On top of these complications, there will always be unobserved differences that evaluators won’t be able to control for between areas selected for benefits and the comparison groups chosen.

17 26 U.S. Code § 45D (e). This section provides a few other definitions for low-income communities, such as: census tracts not located in a metropolitan area with a median family income less than or equal to 80 percent of the statewide median family income; census tracts in a metropolitan area where the median family income is less than or equal to 80 percent of the greater of statewide median family income or the metropolitan area median family income; as well as census tracts that have certain targeted populations or low population.

18 26 U.S. Code § 1400Z-1 (b)(3) states that each population census tract in Puerto Rico that is a low-income community shall be deemed to be certified and designated as a qualified opportunity zone. And 26 U.S. Code § 1400Z-1 (d)(2) states that if the number of low-income communities in a state is less than 100, then a total of 25 of such tracts may be designated as qualified opportunity zones.

19 26 U.S. Code § 1400Z-1 (d)(1).

20 Neumark and Simpson note areas that were eligible for designation but not chosen can provide appropriate control groups for measuring place-based policies. See 18.4.2, “Accounting for selective geographic targeting of policies,” in “Place-Based Policies.”

21 The study of place-based incentive programs has been challenged by the fact that some programs don’t demarcate boundaries that correspond with readily available data. See Neumark and Simpson, “Place-Based Policies.” See also Department of Legislative Services, Office of Policy Analysis, Annapolis, Maryland, “Evaluation of the Enterprise Zone Tax Credit,” November 2013, http://mgaleg.maryland.gov/pubs/budgetfiscal/2013-evaluation-enterprise-zone-tax-credit-draft.pdf.

22 26 U.S. Code § 1400Z-1 (e). “Designation of Tracts Contiguous with Low-income Communities,” states a population census tract that is not a low-income community may be designated if the tract is contiguous with the low-income community designated as a QOZ, and the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tract is contiguous.


24 Even with selection bias, though, evaluators can use other statistical techniques to compensate. For instance, with the use of a regression discontinuity design (RDD) analysis, an evaluator could possibly compare an opportunity zone to a nearby census tract with a poverty rate of 19 percent, just one percentage point below the selection criteria cutoff of at least a 20 percent poverty rate, to be a census tract eligible to be an opportunity zone. This method would basically assume that census tracts slightly above the selection criteria cutoff are similar to those slightly below the selection criteria cutoff, making this similar but non-eligible census tract a good comparison group. And since a tract below 20 percent was not eligible for governors to assign, it would not be impacted by the governor’s selection bias. For more information, see David S. Lee and Thomas Lemieux, “Regression Discontinuity Designs in Economics,” National Bureau of Economic Research, Working Paper 14723, February 2009, https://www.nber.org/papers/w14723.pdf.

25 Andrew Hanson and Shawn M. Rohlin, “Do Spatially Targeted Redevelopment Incentives Work? The Answer Depends on How You Ask the Question.”
Recommendations Going Forward

In May 2019, Senators Booker, Scott, Maggie Hassan (D-NH), and Todd Young (R-IN), put forth a bill, which would require Treasury to report on opportunity zone outcomes annually, five years after the bill’s enactment. It would require data collection, both nationally and at the state level, on the number of QOFs, the amount of QOF assets and their composition by asset class, the percentage of opportunity zones that have received investment, and the impact of the program on economic indicators, “including job creation, poverty reduction, new business starts, and other metrics as determined.” This data would specify the type of investment (such as whether the investment supports a new or existing business), the type of activity (such as whether the investment supports single-family or multifamily residences), and the number of employees a business had at the time of investment.

These requirements would provide evaluators with qualitative data that can show what is happening within and between opportunity zones. For instance, knowing the types of investments supported can help policymakers understand who the program is benefiting. The issue is that researchers would not be able to compare this data to valid comparison groups. For this, evaluators would need data by specific census tract, and a set of comparable economic indicators to compare between opportunity zones and their comparison groups. Evaluators need information on the number of QOFs and the amounts invested by QOFs and qualifying opportunity zone businesses by specific census tracts.

Unfortunately, according to a notice and request for information (notice) put forth by Treasury, the agency is unable to break down this QOF information by specific census tract. In discussing IRS Form 8996—where opportunity zone investors would report on their qualified opportunity zone property and total QOF assets to ensure they qualify for the program’s tax breaks—Treasury’s notice says:

The information reported on the current version of Form 8996 lacks sufficient granularity for the Treasury Department to determine the amount and type of investment that flows into an individual qualified opportunity zone through a QOF. This type of information would be valuable for evaluating the success of the qualified opportunity zone tax incentive on increasing investment and economic activity within qualified opportunity zones.... The Treasury Department anticipates that possible revisions to the Form 8996...could be proposed for tax years 2019 and following.... It is expected that such proposed revisions to the Form 8996 could require...the amount invested by QOFs and qualified opportunity zone businesses located in particular census tracts designated as qualified opportunity zones.

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Reworking Form 8996 so that QOF investment information can be broken down by census tract would aid evaluators in measuring the success of opportunity zones. While qualitative information, such as that which would be required by S. 1344 can help measurement efforts, evaluators need opportunity zone data broken down by census tract so they can compare opportunity zones to a valid comparison group.  

**Conclusion**

Based on the mixed track record of previous place-based incentive programs, measurement is crucial for evaluating the impact of opportunity zones. For opportunity zones to be successful, evaluators need to show they created new opportunities for residents within distressed communities over the long term. And they need to show that these benefits would not have occurred without the program.

While no measurement effort will be perfect, the opportunity zone designation process provides a set of comparison groups in the form of other low-income census tracts that were eligible for the program, but not chosen. Those responsible for collecting data on opportunity zones should make sure data on the number of QOFs, as well as the amount of investments supported by QOFs and qualifying opportunity zone businesses, can be broken down by census tract. This will help evaluators compare Opportunity Zones to valid comparison groups and allow the program's effects to be more accurately measured.

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29 No matter the Form 8996 takes, Treasury must ensure data is collected. Not only have place-based incentive programs presented challenges to evaluators because of their design, measurement efforts have been hampered in some cases by an inability of government offices to collect required data. See Scott Eastman and Nicole Kaeding, “Opportunity Zones: What We Know and What We Don’t.”