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A Place for Place in Federal Tax Law

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Drive about 14 miles west from here on Ohio State Route 81 and just when you cross I-75, before entering downtown Lima, you will find that you have arrived in a different capital gains tax regime. The grass may not be greener on the other side of I-75, but the capital gains tax rules surely are. If you sell a capital asset at a gain and plow the proceeds into an investment here in Ada, you will owe capital gains tax today and potentially will owe more tax when you sell the Ada asset in the future. If you put the proceeds into an investment in downtown Lima instead, you can potentially defer capital gains tax until 2026, reduce your taxable income by 15 percent, and avoid any capital gains tax when you ultimately liquidate your Lima-based holdings.

Downtown Lima is home to a new opportunity zone created under the December 2017 tax law.[1] And it is not the only nearby location where this strange new regime applies. Drive east for 35 miles on U.S. Route 30 and you will arrive at another one of these opportunity zones in Upper Sandusky. You can find another one 40 miles to the northeast, just past Findlay, and yet another east of there in Tiffin. All in all, 320 census tracts across Ohio—in 73 of the state's 88 counties—are now federally designated opportunity zones where investments are potentially subject to much more complicated, but more generous, capital gains tax rules.[2]

The opportunity zone provision of the 2017 tax law is one of the most significant experiments with place-based taxation in federal tax history. It is not the first such effort: the now-expired empowerment zone program, established by Congress in 1993, was an earlier, narrower—and in many respects, better targeted—effort at spatial differentiation in federal taxation.[3] Several other ongoing federal tax programs—including the Low Income Housing Tax Credit and the New Markets Tax Credit—also have strong spatial components.[4] But while place-based taxation is not new, its expansion as part of the 2017 tax law provides an opportune moment to assess what role, if any, geographically differentiated rules ought to play in a tax system that otherwise follows a norm of formal equality with respect to individuals and firms in different domestic locations.

The 2017 tax law's space odyssey is, I will argue, unlikely to be a successful mission in its own right. The new opportunity zones are virtually no one's idea of

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[1] Act of Dec. 22, 2017, Pub. L. No. 115-97, § 13823, 131 Stat. 2054, 2183.

[2] *See Opportunity Zones*, OHIO DEV. SERVS. AGENCY, https://development.ohio.gov/bs/bs_censustracts.htm (last visited June 24, 2019).

[3] Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312.

[4] I.R.C. §§ 42, 45D.

sound tax policy. The legislation is so poorly designed that one wonders whether the flaws might have been intentional: whether this was simply a cynical attempt to give tax breaks to rich donors and more work to well-connected lawyers, all under the guise of aid to distressed communities. I am not yet convinced that the cynical story is right, but not so sure it is wrong either. It is difficult to see how anyone who genuinely sought to lift up communities left behind by the recovery from the Great Recession would have written the law this way.

Yet the design flaws of the opportunity zone program do not (necessarily) augur the failure of all place-based federal tax policies. There are, I will argue, a number of ways in which spatial differentiation can plausibly improve the federal tax system, both on dimensions of efficiency and of equity. An optimistic scenario is that the December 2017 law's foray into spatially differentiated taxation will draw our attention toward more productive uses of place in federal tax policy. But one must don rose-colored glasses in order to glimpse such a scenario, because the opportunity zone program before our eyes inspires little confidence.

My talk today will examine spatially differentiated federal taxation in three parts. The first part will provide a definition of place-based taxation and a description of previous spatially differentiated federal tax programs. The second part will consider the opportunity zone provisions of the December 2017 tax law, outlining their key features and highlighting their deepest flaws. The third part will sketch a number of more promising paths for place-based federal tax policy.

I.

I'll start with a definition. A tax rule is spatially differentiated—or, to say the same thing in fewer syllables, place-based—if its application depends upon the geographic sites at which persons reside, properties are located, or activities occur. Spatial differentiation can—in theory—take a near-infinite number of forms. It might take the form of different exemption amounts or rate structures for taxpayers who reside in different locations. It might take the form of different credits or depreciation schedules for firms that purchase or deploy assets in different areas. Any tax rule can become a spatially differentiated tax rule simply by adjusting its application on the basis of location.

That's what spatial differentiation is—here's what it is not. Spatial differentiation is not the same as interjurisdictional variation. The top state income tax rate here in Ohio is 4.997%.[5] Over the border in Indiana, the state income tax rate is a flat 3.23%.[6] That's interjurisdictional variation, not spatial differentiation. Interjurisdictional variation is foreordained in a federalist system that allows states—and subdivisions within a state—to exercise discretion over their tax rates and bases. Spatial differentiation, by contrast, is not inevitable. It is easy to

[5] *Taxes in Ohio*, TAX FOUND., https://taxfoundation.org/state/ohio (last visited July 14, 2019).
[6] *Taxes in Indiana*, TAX FOUND., https://taxfoundation.org/state/indiana (last visited July 14, 2019).

imagine a system that grants each state the freedom to structure its own tax regime but applies the same rules to all taxpayers at the national level.

Spatial differentiation is also not the same as spatial redistribution, though it will often have that effect. Spatial redistribution occurs when the tax system transfers resources from taxpayers in one location to taxpayers in another. Spatial redistribution is a byproduct of a tax system characterized by progressivity in a country characterized by spatial inequality. A graduated rate structure will result in redistribution from the richest states (Connecticut, Massachusetts, New York) to the poorest states (Mississippi, West Virginia, New Mexico).[7] Specific provisions—like the new $10,000 cap on the state and local tax deduction, or "SALT"—will also have different impacts in different places.[8] The 2017 tax law certainly leads to spatial redistribution—as have revenue statutes throughout U.S. history. That is not unusual. What is more unusual about the 2017 tax law is its explicit spatial differentiation.

Unusual, but not unprecedented. Prior to the Tax Cuts and Jobs Act, federal tax law did explicitly differentiate on the basis of geography in a number of different ways.[9]

First, and least remarkably, federal tax law draws spatial distinctions that track international boundary lines. Section 871 imposes a tax on income earned by nonresident aliens inside the United States but not outside.[10] A number of other provisions make similar inside-outside distinctions.[11] Some amount of differentiation along international boundary lines is the necessary byproduct of a Westphalian system in which each nation-state exercises exclusive sovereignty over a limited territory. Indeed, perhaps the most remarkable aspect of the U.S. tax system's spatial differentiation along international boundary lines is how little of it there is: the United States is unique in applying its tax laws to its own citizens wherever they are.[12]

Second, within the territorial limits of the United States, federal tax law differentiates between the 50 states and the District of Columbia, on the one hand, and the unincorporated territories, on the other. Most residents of unincorporated territories such as Puerto Rico, the U.S. Virgin Islands, and Guam do not pay

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[7] *See Release Tables: Per Capita Income by State, Annual*, FED. RESERVE BANK OF ST. LOUIS, https://fred.stlouisfed.org/release/tables?rid=151&eid=257197 (last visited Aug. 9, 2019) (2017 data).

[8] Pub. L. No. 115-97, § 11042, 131 Stat. 2054, 2085.

[9] The Uniformity Clause of the federal Constitution provides that "all Duties, Imposts and Excises shall be uniform throughout the United States." U.S. CONST. art. I, § 8, cl. 1. In a somewhat confusing confluence of statements, the Supreme Court has said that the Uniformity Clause also applies to taxes, but that explicit geographic distinctions in federal tax law are nonetheless consistent with the clause as long as they do not reflect "an undue preference" for one state over others. *See United States v. Ptasynski*, 462 U.S. 74 80 n.9, 85-86 (1983).

[10] I.R.C. § 871.

[11] *See, e.g.*, I.R.C. § 874 (special rules for deductions and credits for nonresident aliens); I.R.C. § 911 (partial exclusion of income earned by U.S. citizens and residents living abroad).

[12] *See* Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 169, 172 (2016).

federal individual income tax on income from inside those territories.[13] This exemption is sometimes explained as what the territories get for giving up votes in the Senate, the House of Representatives, and the Electoral College.[14] As someone who was born in the District of Columbia and resided there immediately before moving to Chicago, I feel obliged to add that this justification for territorial exemption only aggravates D.C. residents, who also do not send a voting delegation to Congress. The fact that D.C. residents also pay more per capita in federal income tax than residents of any of the 50 states[15] further fuels the outrage expressed on the District's standard-issue license plates, which now read "End Taxation Without Representation."

But our topic today is not taxation on the basis of representation—it is taxation on the basis of location. And prior to the December 2017 tax law, a number of federal tax provisions incorporated quite explicit spatial components.

One of those is the Low-Income Housing Tax Credit, or "LIHTC," first enacted as part of the Tax Reform Act of 1986.[16] The LIHTC program provides tax credits over a 10-year period to investors in residential real estate developments that house low-income tenants. In the normal course, the credits cover up to 70% of the costs of building and rehabilitating low-income units. That figure rises to 91% if the building is in a high-poverty census tract or in a zip code that has high construction, land, and utility costs relative to area median income.[17]

A curious feature of the spatial differentiation embedded in the LIHTC program is that these two criteria—high poverty and high cost—seem to be at cross-purposes with each other. High-poverty areas tend to be the places where land is cheap; high-cost areas tend to be places where poverty is low. Since either high poverty or high cost can be a trigger for the souped-up credit, the net effect of these provisions is to incentivize LIHTC projects to locate either in the poorest parts of town or in the richest. Thus, developments in the Watts area of Los Angeles—where nearly 40% of the population lives below the poverty line—are eligible for the enhanced credit, but so too are developments in the famously wealthy Beverly Hills 90210 zip code.[18]

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[13] I.R.C. §§ 931, 933.

[14] *See, e.g.*, 164 Cong. Rec. H9399 (Sept. 28, 2018) (statement of Del. Norton) ("[T]he reason that most of the territories don't come forward and ask for statehood is very clear. There is a quid pro quo for them. In exchange for not paying Federal taxes, they don't have the votes in Congress.").

[15] Stephen Ohlemacher, *Which State Sends Most Taxes to DC? Hint: It's Not a State*, ASSOC. PRESS (Apr. 16, 2017), https://apnews.com/bb851fbec8e7463cbef631abd070888a.

[16] I.R.C. § 42; *see* Tax Reform Act of 1986, Pub. L. No. 99-514, tit. II, § 252(a), 100 Stat. 2189.

[17] I.R.C. § 42(d)(5)(B).

[18] *See* 2019 IRS Section 42(d)(5)(B); Qualified Census Tracts (2019), https://www.huduser.gov/portal/Datasets/qct/QCT2019M.PDF (listing census tracts 2420.00, 2422.00, 2423.00 2427.00, 2430.00, and 2431.00); I.R.C. § 42(d)(5)(B) Metropolitan Difficult Development Areas (2019), https://www.huduser.gov/portal/Datasets/qct/DDA2019M.PDF (listing 90210 area code).

Because building a low-income housing development in a high-cost area is much harder than siting it in a high-poverty neighborhood, the spatial differentiation within LIHTC primarily pushes developers toward already-impoverished places. This aspect of LIHTC has generated quite a bit of criticism.[19] The concern is that by encouraging developers to pack more low-income families into already low-income neighborhoods, LIHTC contributes to the concentration of poverty and exacerbates existing patterns of economic and racial segregation.

Defenders of LIHTC's spatially differentiated incentives have a response to this critique. They point out that through much of the 20th century, federal policies such as mortgage "redlining" diverted investment away from low-income, largely minority communities. Defenders of LIHTC's spatially differentiated incentives can argue that the preference since the late 1980s for development in high-poverty areas acts as a corrective to the decades of disinvestment that preceded the program.[20] They can also point to evidence that links LIHTC-backed projects in high-poverty areas to higher property values and lower crime rates.[21] More generally, they can argue that the primary problem plaguing high-poverty areas is not that they have too many poor people; it's that they have too little capital. In this view, channeling capital investment toward high-poverty areas is precisely what federal policy ought to be doing.

The next major spatially differentiated tax legislation came in the first year of the Clinton administration, when Congress established the "empowerment zone" program as part of the 1993 omnibus budget bill.[22] Roughly 100 high-poverty, high-unemployment communities were designated under the program as empowerment zones. Businesses in empowerment zones received a number of targeted tax incentives. Chief among them was a credit of up to $3000 for each worker they employed who lived inside the zone. The program cost the federal government approximately $2.5 billion over its first decade,[23] a drop in the bucket compared to LIHTC, which carries a price tag over $9 billion per year.[24]

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[19] *See, e.g.*, Michelle D. Layser, *How Federal Tax Law Rewards Housing Segregation*, 93 IND. L.J. 915 (2018).

[20] *See, e.g.*, Daniel Hemel, *Is the Low-Income Housing Tax Credit "Keeping Cities Segregated"?*, MEDIUM: WHATEVER SOURCE DERIVED (July 3, 2017), https://medium.com/whatever-source-derived/is-the-low-income-housing-tax-credit-keeping-cities-segregated-9cbcc819e241.

[21] *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 (2019).

[22] Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103–66, tit. XIII, § 13301, 107 Stat. 543–554 (codified as amended at I.R.C. §§ 1391–1397).

[23] Matias Busso & Patrick Kline, *Do Local Economic Development Programs Work? Evidence from the Federal Empowerment Zone Program* 7 (Nat'l Burea of Econ. Research, Working Paper, July 22, 2008), https://www.nber.org/conferences/2008/si2008/PERE/busso.pdf.

[24] Staff of the Joint Comm. on Taxation, JCX-81-18, Estimates of Federal Tax Expenditures for Fiscal Years 2018-2022, 25 (Oct. 4, 2018), https://www.jct.gov/publications.html?func=startdown&id=5148.

Several studies have scrutinized the empowerment zone program, which expired at the end of 2017.[25] The available evidence suggests that the program did, as intended, generate additional jobs inside empowerment zones, but at a very high price: each new position came at a revenue cost to the federal government of over $100,000.[26] Some of these jobs may simply have been shifted from locations outside the zones. And on top of that, the small boost to employment inside empowerment zones came with a sharp increase in rents. Much of the benefit of the program appears to have been captured by landlords in empowerment zones rather than by low-income resident themselves.

The enactment of the empowerment zone program was followed seven years later by the New Market Tax Credit.[27] That program provides a tax credit for investments in high-poverty communities that are channeled through so-called "community development entities," or CDEs. The tax credit is worth thirty-nine percent of the investment and is realized over the course of seven years.[28] CDEs must incorporate community members in their governance process (for example, by allocating a certain share of their director or officer positions to community members), and they must compete with each other for new credit allocations from the Treasury Department, which exercises continuing oversight.[29] The revenue cost of the program is now slightly over $1 billion per year,[30] and the credit is set to expire at the end of 2019 unless Congress extends it,[31] as it has several times in the past.

The most recent round of spatially differentiated tax provisions prior to the Tax Cuts and Jobs Act have targeted areas hit by natural disasters. The package passed after Hurricane Katrina in 2005 was the most generous: For taxpayers in Katrina-affected areas, it temporarily removed limitations on the casualty loss deduction, allowed for tax-free debt cancellation, and permitted penalty-free withdrawals from 401(k)s and IRAs.[32] Congress passed a similar measure after Hurricanes Harvey, Irma, and Maria in 2017,[33] just weeks before it turned to the Tax Cuts and Jobs Act.

II.

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[25] I.R.C. § 1391(d)(1)(A).

[26] Edward L. Glaeser & Joshua D. Gottlieb, *The Economics of Place-Making Policies*, BROOKINGS PAPER ON ECON. ACTIVITY, 155, 157 (Spring 2008).

[27] § 45D.

[28] DONALD J. MARPLES & SEAN LOWRY, CONG. RESEARCH SERV., RL34402, NEW MARKETS TAX CREDIT: AN INTRODUCTION 1 (2019).

[29] *Id.* at 2.

[30] See Staff of the Joint Comm. on Taxation, *supra* note 12, at 27.

[31] § 45D(f)(1)(G).

[32] Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, 119 Stat. 2015.

[33] Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, 131 Stat. 1168.

It was against this historical backdrop that Congress enacted the new opportunity zone program as part of the Tax Cuts and Jobs Act of December 2017.[34] The opportunity zone provision effectively incorporates the worst elements of earlier spatially differentiated tax incentives while leaving out the redeeming qualities. Like the Low-Income Housing Tax Credit and the New Markets Tax Credit, it is extraordinarily and unnecessarily complicated—almost as if it were intentionally designed to create more work for accountants and tax lawyers. But unlike those programs, there is little in the opportunity zone package that appears aimed at creating more affordable housing or jobs for low-income workers. Usually in tax policy, there is a tradeoff between complexity and targeting: a provision can be simple, but its simplicity comes at the expense of narrow targeting, or a provision can be precisely targeted but as a result it will need to be quite complex. The opportunity zone program scores an impressive two-for: it manages both to be complicated and poorly targeted at the same time.

The basics of the opportunity zone program are as follows: Each governor had until March 2018 to designate a quarter of the low-income census tracts in her state as opportunity zones.[35] To qualify, a census tract had to have a poverty rate of at least 20% or a median family income less than 80% of the median income in its metropolitan area or state.[36] A small number of census tracts that were not "low-income" by this definition but were next to low-income communities could also receive the opportunity zone designation.[37] The IRS then approved each state's designation between April and June of last year.[38]

Taxpayers can now invest in qualified opportunity funds, which are forming by the day, and which in turn invest in qualified opportunity zones. These investments are eligible for two different sets of benefits. The first is deferral and potential reduction of capital gains taxes at the time of investment. If I am a top-bracket taxpayer and I sell an asset with a $100 gain, I would normally pay a tax of $23.80 this year. If I put the $100 in an opportunity fund and keep it there until 2026, I can defer my capital gains tax bill until then, and instead of paying tax on $100, I will pay tax on $85.[39] The second benefit comes when I sell my opportunity

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[34] The law's official name is "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," after the Senate parliamentarian—in a debatable interpretation of the upper chamber's Byrd Rule—struck the more succinct "Tax Cuts and Jobs Act" moniker. *See* Ellen P. Aprill & Daniel J. Hemel, *The Tax Legislative Process: A Byrd's Eye View*, 81 L. & CONTEMP. PROBS. 99, 100, 125 (2018).

[35] *See* § 1400Z-1; *see also Treasury, IRS Announce First Round of Opportunity Zones Designations For 18 States*, U.S. DEP'T OF THE TREASURY (Apr. 9, 2018), https://home.treasury.gov/news/press-releases/sm0341 (noting that March 21, 2018 was the deadline for a governor to submit designations or request a 30-day extension).

[36] *See* § 45D(e); *see also* § 1400Z-1(c).

[37] *See* § 1400Z-1(e).

[38] *See 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.

[39] § 1400Z-2(a)-(b).

fund holdings. If I hold onto the investment for ten years, so until 2029, then I will owe no capital gains tax on my opportunity fund gains.[40]

The statute requires that qualified opportunity funds invest ninety percent of their assets in qualified opportunity zone property.[41] Qualified opportunity zone property includes stock in a corporation or an interest in a partnership if, according to the statute, "substantially all" of the corporation or partnership's tangible property is inside the opportunity zone. The Treasury Department and the IRS have proposed regulations that would interpret "substantially all" in that context to mean "at least 70 percent"[42]—which seems to be quite a stretch of the English language.[43] I would like to know how Treasury officials would feel if a young daughter or son of theirs claimed to have completed "substantially all" of the evening's homework but had in fact left thirty percent undone. In any event, the net effect is that a taxpayer can benefit from the opportunity zone provision if she invests in a fund that invests ninety percent of its assets in businesses that hold seventy percent of their property in opportunity zones, which means that at the end of the day, only sixty-three percent of the investment needs to go into the areas that the statute was intended to lift up.

The fact that a taxpayer can claim one hundred percent of the benefits of the opportunity zone program when less than two-thirds of that taxpayer's investment goes toward a low-income community is just one among a number of ways in which the provision is poorly targeted. First, unlike LIHTC, there is nothing in the opportunity zone program that appears aimed at expanding access to affordable housing. A developer could buy a building in an opportunity zone currently occupied by low-income tenants, tear it down, replace it with luxury rentals, and claim the opportunity zone tax benefits. Second, unlike the empowerment zone program's work credit, there is nothing in the opportunity zone provision that ensures that investments receiving tax preferences will generate jobs—for low-income workers or for anyone else. An enterprise could, for example, acquire an existing factory in a high-poverty area, fire all the workers, replace them with robots, and still claim all the opportunity zone tax benefits for its investment. Third, unlike the New Markets Tax Credit, there is nothing in the opportunity zone statute that provides for community accountability or Treasury oversight.[44]

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[40] § 1400Z-2(c).
[41] § 1400Z-2(d).
[42] Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18,652, 18,688 (May 1, 2018).
[43] In the accounting context, "'[s]ubstantially all' is commonly considered to be approximately 90%." *The New Business Definition: Why It Matters*, PRICEWATERHOUSECOOPERS: IN THE LOOP, Feb. 2018, at 2, https://www.pwc.com/us/en/cfodirect/assets/pdf/in-the-loop/fasb-new-definition-of-business.pdf.
[44] A new working paper by Alan Sage, Mike Langen, and Alexander Van de Minne finds that opportunity zone designation led to a 14 percent increase in the price of "redevelopment properties" (i.e., apartments older than 60 years and other buildings older than 30 years) and a 21 percent increase in the price of vacant land. Alan Sage, Mike Langen, and Alexander Van de Minne, *Where Is the Opportunity in Opportunity Zones? Early Indicators of the Opportunity Zone Program's Impact on Commercial Property Prices* 2, 18 (June 1, 2019) (unpublished

Perhaps the only saving grace of the opportunity zone program is that the tax benefits might turn out not to be so large. The Joint Committee on Taxation initially estimated a revenue cost of approximately $1.6 billion over the course of a decade[45]—or slightly more than one-one thousandth of the total cost of the December 2017 tax law. Opportunity zones lose money for the federal government until 2025 and then lead to higher capital gains tax collections in 2026, when taxpayers who deferred gains when they made their initial opportunity zone investments will now owe Uncle Sam.

The revenue cost of opportunity zones could be even smaller if capital gains rates rise between now and 2026. Recall that when you roll capital gains into a qualified opportunity fund today, you defer your liability until 2026 and you pay tax only on eighty-five cents of every one dollar of realized gains. What you do not do is lock in current capital gains rates. So, if we find ourselves with a Democratic-majority Congress and a Democratic president who eliminate the preferential rate for long-term capital gains, opportunity zone investors may pay a much larger bill in 2026 than if they had paid tax on their gains today at current rates.

The second tax benefit of opportunity zones—the elimination of tax on all capital gains for investments held longer than a decade—also turns out to be somewhat less than advertised. Section 1202, the qualified small business stock provision, already allows taxpayers to erase tax on capital gains for small-business investments held longer than five years. "Small business" in section 1202 does not mean "small" by your and my standards: the business may have assets of up to $50 million at the time of the investment and still qualify.[46] There are, to be sure, industry-specific limitations in section 1202 that are more onerous than the opportunity zone provisions. For example, section 1202 cannot be used for businesses that operate hotels and restaurants, while the opportunity zone benefits can be.[47] But most of the income from operating a hotel or restaurant will be ordinary income, not capital gains, and will be taxed at normal rates regardless of whether the taxpayer channels her investment through a qualified opportunity fund.

Section 1202 aside, there is an easier way to eliminate tax on capital gains entirely without investing through a qualified opportunity fund—and that is to die. Stepped-up basis at death applies to all capital assets,[48] and it requires many fewer lawyer hours than an opportunity zone investment will. Moreover, if you sell an

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manuscript), https://ssrn.com/abstract=3385502. The authors interpret this to mean that much of the tax benefit of the opportunity zone provisions is captured by existing owners. *Id.* at 3. The authors also find no significant effect on other properties, which they interpret to mean that investors do not expect the provision to produce future net operating income growth for opportunity zone businesses. *Id.* at 2-3.

[45] Staff of the Joint Comm. on Taxation, JCX-67-17, Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act" 6 (Dec. 18, 2017), https://www.jct.gov/publications.html?func=startdown&id=5053.

[46] I.R.C. § 1202(d).

[47] § 1202(e)(3).

[48] § 1014.

asset for a capital gain today, plow the gains into a qualified opportunity fund, and then die before 2026, your heirs lose the stepped-up basis benefit that they otherwise would have received if you had held onto the initial asset until the end of your life.[49]

I should acknowledge at this point that my views about the tax benefits of opportunity zones are somewhat contrarian: Listen to tax lawyers and accountants and you will hear that the opportunity zone provisions will allow taxpayers to achieve "tremendous savings"[50] and "could potentially enable trillions of dollars in current and future capital gains to be deferred. . . ."[51] And of course they say that: No tax practitioner ever wooed a client by advertising a modest tax-reduction opportunity that may end up costing more in legal fees than it achieves in actual savings. There are, however, at least two points on which the opportunity zone promoters and I can achieve consensus.

First, in terms of scope, the opportunity zones are indeed unique among the spatially differentiated tax provisions that Congress has enacted so far. There are approximately twelve times as many opportunity zone census tracts as there were empowerment zone census tracts: 8,762 versus 728.[52] Unlike LIHTC, which is limited to a specific asset class (namely, residential real estate), the opportunity zone tax benefits potentially apply to any type of investment in tangible property. And whereas LIHTC and the New Markets credit are subject to binding dollar limitations, the benefits of the opportunity zone provisions are uncapped (though I would eat my hat if they turn out to be in the trillions, or even the tens of billions).

Second, in terms of the amount of attention that they have generated, the opportunity zone provisions are unique among spatially differentiated tax provisions as well. According to the LexisNexis database, the number of North American newspaper stories referencing opportunity zones in the first year after the Tax Cuts and Jobs Act was about 33 times the number of newspaper stories

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[49]Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 18,677; *see also* Libin Zhang, *INSIGHT: Qualified Opportunity Zones: Death, Taxes, and Other Uncertainties*, BLOOMBERG TAX (Jan. 10, 2019, 9:41 AM), https://news.bloombergtax.com/daily-tax-report/insight-qualified-opportunity-zones-death-taxes-and-other-uncertainties.

[50] Barton LLP, *Qualified Opportunity Zones–New Opportunities in Real Estate*, BARTON BLOGS (Nov. 9, 2018), https://www.bartonesq.com/qualified-opportunity-zones-new-opportunities-in-real-estate.

[51] Glenn Blumenfeld, *The New Opportunity Zones Are Great, but Proceed with Caution*, PHILADELPHIA BUSINESS JOURNAL (Oct. 19, 2018, 1:56 PM), https://www.bizjournals.com/philadelphia/news/2018/10/19/the-new-opportunity-zones-are-great-but-proceed.html.

[52] *Compare* Justin Fox, *The Last Great Neoliberal Experiment Comes to a Neighborhood Near You*, BLOOMBERG OPINION (June 18, 2019), https://www.bloomberg.com/opinion/articles/2019-06-18/trump-opportunity-zones-are-the-last-great-neoliberal-experiment (8,762 opportunity zone census tracts), *with* U.S. DEP'T OF HOUS. & URBAN DEV., COMMUNITY PLANNING AND DEVELOPMENT—EMPOWERMENT ZONES/ENTERPRISE COMMUNITIES/RENEWAL COMMUNITIES—2012 SUMMARY STATEMENT AND INITIATIVES, at AA-2 (2011), https://www.hud.gov/sites/documents/Empowerment_Zones2012.pdf (728 empowerment zone census tracts).

referencing empowerment zones in the first year after their creation in 1993—1,129 versus 34.[53] LIHTC and the New Markets credit were barely a blip on the media's radar when those programs were rolled out. Spatially differentiated taxation is arguably having its first real prime-time moment. Alas, given the opportunity zone program's deep flaws, it is doubtful that the debut performance will dazzle.

III.

Whether we should lament this result depends on whether we think well-designed spatially differentiated tax provisions hold much promise. I think they plausibly do, though my conclusions are tentative and the programs I am envisioning would take a rather different form than earlier and existing place-based tax rules.

The case for spatial differentiation must be based on something more than a redistributive impulse. If we want to provide affordable housing to low-income families, we can do that by rewarding developers that house low-income families or by providing rental subsidies to the families themselves. There is no obvious reason to base the provision on place when we can target the subsidy with precision at the very people whom we want to aid. Likewise, if we want to encourage businesses to create jobs for low-income workers, we can provide tax credits for hiring low-income workers. There is no obvious reason to target the credits at all residents of low-income areas, who in some cases might not be low-income themselves, and there is likewise no obvious reason to limit the credits to residents of low-income areas, as some low-income families might live elsewhere. For spatially differentiated taxation to make sense, it must be the case that we learn something from the characteristics of *places* that we cannot just as easily learn by observing the characteristics of *people*.

One potential use of location in taxation that seems to satisfy this criterion is the idea of place as a tag. This idea is drawn from drafts of a forthcoming paper in the *Journal of Political Economy* by the Berkeley economist Danny Yagan.[54] Yagan's idea is as follows: in tax, we are always looking for "tags"—indicators of need or ability to pay other than income. The problem with calculating taxes on the basis of income is that income is itself responsive to taxes. When we redistribute from high-income individuals to low-income individuals, we discourage work and investment. Ideally, we would have some way of measuring your income-earning opportunities other than income itself—such as if the IRS could observe your IQ.

Yagan suggests that under certain circumstances, place can function as just such a tag. The Great Recession swept through some parts of the country like a category 5 hurricane and elsewhere was more like an economic tropical storm.

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[53] Search conducted by Lexis Advance Research on June 24, 2019. Date ranges (search terms): December 22, 2017, to December 21, 2018 ("opportunity zone") and August 10, 1993, to August 9, 1994 ("empowerment zone").
[54] *See* Danny Yagan, *Moving to Opportunity? Migratory Insurance Over the Great Recession* (Jan. 2014) (unpublished manuscript), https://eml.berkeley.edu/~yagan/MigratoryInsurance.pdf.

Individuals in some areas, like Phoenix, Arizona, fared much worse than those in other areas, like San Antonio, Texas.[55] These differential effects persist more than a decade after the recession began.[56] We might think of living in Phoenix at the time of the Great Recession in the same way we think of living in New Orleans at the time of Katrina: as a fact out of your control that has affected your ability to accumulate income. For much the same reason as we want to redistribute to individuals who lived in New Orleans in 2005, we might also want to redistribute to individuals who lived in Phoenix when the Great Recession hit shortly thereafter. This is a way of redistributing on the basis of need—or ability to pay—without distorting incentives to earn income in the future.

We could use mechanisms other than taxation to accomplish this type of redistribution, but the tax system has certain advantages. In most cases, the IRS already knows where you lived in 2008. It can adjust tax liabilities on that basis at little administrative cost. It can track down former Phoenix residents who now live somewhere else, and it can distinguish between current Phoenix residents who were there at the onset of Great Recession and current Phoenix residents who lived elsewhere at that time.[57]

To be clear, the idea here is to use place as a backward-looking tag for redistribution, not to adjust taxes based on where you live now. The idea works best in the aftermath of a cataclysmic economic event; it works less well if the intervention is anticipated. Tagging on the basis of past place may therefore be only a one-time tool. If too often repeated, it may have the perverse effect of encouraging individuals to remain in the path of an economic storm rather than relocating to a place with greater employment opportunities.

Another potential use of place in taxation emerges from the literature on "moving to opportunity." Moving to Opportunity was a randomized controlled trial conducted across five U.S. cities between 1994 and 1998 in which nearly 5000 families with children in public housing projects participated. Some participants received standard Section 8 Housing Choice vouchers that they could use anywhere that took Section 8. Others received "moving to opportunity" vouchers that they could only use if they relocated to a low-poverty area. The idea was that if concentrated poverty generates significant harms, then the families that received the "moving to opportunity" vouchers should fare better on measurable dimensions than the others.[58]

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[55] *Id.* at 2.

[56] Danny Yagan, *The Enduring Employment Impact of Your Great Recession Location* (Institute for Research on Labor and Employment, Working Paper No. 108-16, 2016), http://irle.berkeley.edu/the-enduring-employment-impact-of-your-great-recession-location.

[57] The argument for IRS administration of retrospective place-based payments accords with the idea that responsibility for spending programs should be allocated on the basis of institutional competencies. *See generally* David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955 (2004).

[58] The design of the experiment and the results are summarized in LISA SABONMATSU ET AL., MOVING TO OPPORTUNITY FOR FAIR HOUSING DEMONSTRATION PROGRAM: FINAL IMPACTS EVALUATION—PREPARED FOR U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT OFFICE

The results were mixed. A decade later, adults in the families that "moved to opportunity" were no more likely to be employed than the control group, and they did not earn measurably higher wages. But rates of extreme obesity and diabetes were markedly lower among adults in the moving-to-opportunity families. Test scores for children in those families did not exhibit immediate improvement, but children whose families moved to low-poverty areas when they were younger than thirteen years old showed significantly improved long-term educational and economic outcomes. Harvard economists Raj Chetty, Nathaniel Hendren, and Lawrence Katz estimate that moving a child and her family out of a high-poverty housing project and into a low-poverty area when she is eight or younger will increase her lifetime earnings by somewhere around $300,000.[59]

These findings are amenable to a number of possible interpretations, and the scholarly debate over the implications of the Moving to Opportunity experiment is far too rich to summarize succinctly. One possible inference is that growing up in an environment of concentrated poverty produces tangible and long-lasting harms. If so, then a worthy social objective might be to encourage some higher-income households in high-income areas and some lower-income households in low-income areas to swap location, which would have the effect of deconcentrating poverty overall.

This normative claim is tentative because the existing evidence is incomplete. As researchers involved in the Moving to Opportunity experiment acknowledge, the experiment tells us only about the effects of moves on families initially living in high-rise public housing in high-poverty neighborhoods of Baltimore, Boston, Chicago, Los Angeles, and New York in the mid-1990s.[60] And even among this population, the results tell us only about the effect of moves on families who participated in the experiment (i.e., who "were at least somewhat interested in moving and sufficiently organized to take note of the opportunity and complete an application").[61] The Moving to Opportunity results may be—but are not necessarily—generalizable to other populations (e.g., homeowners and renters of privately owned units) in other cities or suburban and rural areas in other time periods. Moreover, participants in the experiment had limited neighborhood-specific social capital. More than half of household heads reported at the outset that they had "no friends" in their initial neighborhood, and nearly two thirds had no family in the neighborhood either.[62] Moving from a low-income neighborhood to a high-income neighborhood may be less beneficial if the movers leave behind networks of friends and family. And the Moving to Opportunity experiment tested only one half

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OF POLICY DEVELOPMENT & RESEARCH (Oct. 14, 2011), https://www.huduser.gov/portal/publications/pubasst/MTOFHD.html.

[59] Raj Chetty, Nathaniel Hendren & Lawrence F. Katz, *The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment*, 106 AM. ECON. REV. 859-60 (2016).

[60] Jens Ludwig et al., *What Can We Learn About Neighborhood Effects from the Moving to Opportunity Experiment?*, 114 AM. J. SOCIOL. 144, 154-55 (2008).

[61] *Id.* at 155.

[62] *Id.* at 155-56.

of the household-swap equation: the movement of low-income households into higher-income neighborhoods. We do not know the effect of high-income households moving into low-income neighborhoods (either on themselves or on their new neighbors).[63]

With these considerable caveats in mind, spatially differentiated taxation suggests a potential way to facilitate the deconcentration of poverty and the emergence of more socioeconomically heterogeneous neighborhoods. We might imagine, for example, spatially differentiated income tax rate structures: steeply progressive rate structures in low-poverty areas and flatter rate structures in high-poverty areas. Households at the bottom of the income ladder would therefore have an incentive to move to high-income areas, where they would benefit from the additional progressivity,[64] while households at the top of the income ladder would have an incentive to move to low-income areas, where they would benefit from flatter rates. Given the persistent correlation between income and race, spatially differentiated rate structures could also help to accomplish what a half-century of fair housing law has largely failed to bring about: it could encourage higher-income, disproportionately white families to relocate to areas that were historically communities of color, and enable members of minority groups to move into areas that have long been bastions of whiteness.

The idea of using federal tax policy to encourage economic integration—and with it, racial residential mixing—will almost certainly engender controversy. The movement of high-income households into low-income areas is sometimes characterized—and criticized—as "gentrification"[65] (though note that the movement of high-income households into low-income areas will almost certainly need to occur if residential integration along racial and ethnic lines is to become a reality[66]). Critics of spatially differentiated rate structures also might argue that politicians in Washington ought to get out of the business of choosing who lives, works, and

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[63] A new working paper by Quentin Brummet and Davin Reed examines this other half, though results are inconclusive. Brummet and Reed find that that the entry of high-income households into low-income neighborhoods reduces exposure to neighborhood poverty for original residents (adults and children) and leads to higher home values for original residents who owned their homes. Quentin Brummet and Davin Reed, *The Effect of Gentrification on the Well-Being and Opportunity of Original Resident Adults and Children* 2, 18-20, 22-23 (Fed. Reserve Bank of Phila., Working Paper No. 19-30, July 2019), https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2019/wp19-30.pdf. The authors do not, however, find consistent effects on employment or income for original residents, nor do they find consistent effects on educational attainment for original resident children. *See id.* at 35 tbl.5, 37 tbl.7.

[64] Note that zero is not a lower limit on the marginal or effective tax rate. Congress could set a negative tax rate for low-income residents of high-income neighborhoods so that these households can better afford the cost of the move and higher rents in their new environs.

[65] Michelle Layser, for example, characterizes the idea of "integration . . . as a solution to urban poverty" as an implicitly "pro-gentrification" objective. *See* Michelle D. Layser, *The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform*, WIS. L. REV. (forthcoming 2019), https://ssrn.com/abstract=3347401 (manuscript at 48-49).

[66] *See* Hemel, *supra* note 20.

invests where. To be sure, existing patterns of residence, employment, and investment are also not the outgrowth of an unbridled free market. They are products of policy choices—redlining, enforcement of racially restrictive covenants, mid-century urban renewal efforts, and so on.[67] To refrain from place-based policymaking today is to allow the dead hand of past place-based policies to rule us in the present.

A third path for spatially differentiated federal taxation builds on the work of Princeton economists Adrien Bilal and Esteban Rossi-Hansberg, who observe that location can serve as an asset that facilitates resource transfers across time.[68] One way to think of it is as follows: We can transfer wealth to our children by bequeathing financial assets to them; we can also transfer wealth to our children by raising them in amenity-rich places like Indian Hill outside Cincinnati, Pepper Pike to the east of Cleveland, and New Albany near Columbus. Raising children in these sorts of places endows them with human capital, social capital, and oftentimes political capital just as the transfer of financial assets endows them with economic capital.

The perpetuation of inequality across generations is, most would agree, one of the more vexing policy challenges that we as a nation face. The United States has for the most part given up on the idea of taxing intergenerational wealth transfers, though the federal estate and gift taxes remain nominally in effect.[69] If we are ever to recommit ourselves to the idea of using the tax system to achieve a more level intergenerational playing field, we will have to grapple with the reality that wealth transfer occurs through locational assets as well as through financial assets. Should adults who were reared in Indian Hill or Pepper Pike or New Albany owe some sort of inheritance tax on their suburban upbringings? The idea may seem crazy at first, but a comprehensive tax on intergenerational wealth transfers might contemplate this notion.

These proposals are all quite preliminary and I look forward to ideas from other symposium participants. A robust regime of spatially differentiated taxation raises questions that today's talk has only scratched upon. The promise of place-based taxation should not be judged solely on the basis of its past, and certainly not on the basis of the present opportunity zone mess. We may conclude upon reflection that the administrative and political challenges of spatially differentiated taxation render the game not worth the candle. My working hypothesis, though, is that there is indeed a place for place in federal tax law. The 2017 tax law may have been an inauspicious start to federal tax law's space odyssey—or, more accurately, an ill-fated expedition following a number of earlier forays. But spatially differentiated

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[67] For an excellent overview, see RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA (Liveright Publ'g Corp. 2017).
[68] Adrien Bilal & Esteban Rossi-Hansberg, *Location as an Asset* (Apr. 22, 2019) (unpublished manuscript), https://www.princeton.edu/~erossi/LA.pdf.
[69] On the decline of the estate tax since 2001, see POLICY BASICS: THE FEDERAL ESTATE TAX, CTR. FOR BUDGET & POLICY PRIORITIES (Nov. 7, 2018), https://www.cbpp.org/sites/default/files/atoms/files/policybasics-estatetax.pdf.

federal taxation is not necessarily a doomed enterprise. If the opportunity zone experiment motivates more careful, creative thinking about the relationship between location and taxation, then something potentially positive will have emerged from the experience.