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THE MARYLAND HOUSE OF DELEGATES
Annapolis, Maryland 21401

Testimony in Support of HB 262
Opportunity Zone Tax Deduction Reform Act of 2021

Summary

The 2017 federal tax reforms allow wealthy investors and corporations to write off part or all of their capital gains taxes when they invest in an opportunity zone fund. Currently, these investors receive a break on both their federal and state taxes, even if the money is invested outside of Maryland.

This bill would decouple Maryland from the federal tax incentives for opportunity zones. If Maryland decouples from the federal government on this particular tax provision, we will retain $13-$15 million per year.

This bill passed the House of Delegates in 2020.

Opportunity Zones Aren't Working

Several studies have been conducted on the outcomes of opportunity zones to date. The findings are universally underwhelming, from opportunity zones having "very limited" impacts on job creation[1] to directing only 3.5% of total funding to operating businesses and instead investing heavily in real estate developers.[2] Additionally, researchers have found that opportunity zone investments have not been distributed equitably, with women, minority, and lower-income stakeholders largely being shut out.[3]

An analysis of opportunity zones by the Urban Institute found that "although there are compelling examples of community benefit, the incentive as a whole is not living up to its economic and community development goals. The incentive's structure makes it harder to develop projects with community benefit in places with greatest need. In

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[1] "What is the Impact of Opportunity Zones on Employment Outcomes?" Rachel Atkins et. al. August 2020, NYU Stern School of Business.

[2] https://www.urban.org/research/publication/early-assessment-opportunity-zones-equitable-development-projects/view/full_report

contrast, OZs are providing the biggest benefits to projects with the highest returns, which are rarely aligned with equitable development."[3]

Additionally, developers and opportunity zone fund managers surveyed by researchers mostly report that tax incentives were not critical to their project, as some had already committed to their projects before their opportunity zone even existed.[3]

Investors in Opportunity Zones are Ultra Wealthy

The federal rules that created opportunity zones specify that only capital gains can be invested in an opportunity zone fund. Capital gains are the profits from the sale of an asset, such as stocks, bonds, or real estate. Less than 10% of American taxpayers have capital gains, and those that do are among the wealthiest Americans. Because of the federal restrictions on what funds can be invested in an opportunity zone, this means that only wealthy people and businesses are able to invest in opportunity zone funds.

As documented in an August 2019 article published by the *New York Times*, the opportunity zone tax breaks will result in billions of dollars in untaxed profits for wealthy investors, including members of President Trump's family and many real estate developers.[4] "Opportunity zones are intended to attract investors to distressed areas," the article stated, "but so far, much of their money is going to create luxury projects… While some money is flowing to poor communities, the most visible impact so far has been to set off a feeding frenzy among the wealthiest Americans. They are poised to reap billions in untaxed profits on high-end apartment buildings and hotels in trendy neighborhoods, storage facilities that employ only a handful of workers or student housing in bustling college towns."

Opportunity Zone Investors Get a Huge Tax Break

Under federal law, investors in opportunity zone funds get three significant benefits. First, they can defer paying capital gains taxes on their original investment until 2026 (or whenever the opportunity zone investment is sold, if earlier), which allows them to invest the entire sum and thereby potentially earn even more money. Second, their tax liability is reduced by 10% if they maintain their opportunity zone investment for five years and by 15% if held for seven years. Third, after 10 years, **the investor pays no capital gains taxes** on their profit from the sale of an opportunity zone investment.

[3] https://www.urban.org/urban-wire/opportunity-zone-incentive-isnt-living-its-equitable-development-goals-here-are-four-ways-improve-it
[4] https://www.nytimes.com/2019/08/31/business/tax-opportunity-zones.html

The California Budget and Policy Center provides an example of how lucrative these tax breaks are.[5] Imagine a Marylander who invests $100,000 in capital gains in an opportunity zone fund. They leave the money invested for 10 years and get an annual rate of return of 8%. In total, the resident would now have $215,000–a profit of $115,000. Because of the tax breaks, they would pay $20,230 in federal taxes and save an additional $30,940 on their federal taxes. This results in an effective tax rate of only 9.4% versus the 20% they otherwise would have owed on regular capital gains.

There is no limit to the amount of tax breaks a single entity or opportunity zone can receive, nor any limits on the total federal and state costs (in terms of reduced revenues) for the opportunity zone program.[6]

Investors Get Tax Breaks for Investing in Other States

Maryland taxpayers are not limited to investing in opportunity zones in Maryland; they can invest in any state and get a tax break in Maryland under the current law. Investments outside of Maryland are likely to be fairly common, as most opportunity zone funds plan to invest in multiple states. In fact, a directory of 216 opportunity zone funds lists only two funds that will invest only in Maryland, as opposed to 7 plans that will invest in Maryland plus other states and 66 plans that are nationwide in scope.[7]

Why We Need to Decouple

The federal government created tax breaks for opportunity zone investors, but that doesn't mean that Maryland has to further extend these expensive tax breaks. We can save millions of dollars by decoupling our individual and corporate income taxes from the federal government in regards to opportunity zones.

The Institute on Taxation and Economic Policy and the Center on Budget and Policy Priorities—both of which are non-partisan policy research organizations—have recommended that states decouple from the federal government in regards to opportunity zones.

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[5] https://calbudgetcenter.org/resources/the-federal-opportunity-zones-program-and-its-implications-for-california-communities/

[6] Government Accountability Office, October 2020, "Opportunity Zones: Improved Oversight Needed to Evaluate Tax Expenditure Performance."

[7] www.ncsha.org/resource/opportunity-zone-fund-directory/

This would be a narrow change in our state tax code and is not tied to decoupling in regards to the standard deduction. Moreover, this change would not impact the tax credits the General Assembly passed in 2019 to incentivize businesses to open or expand in opportunity zones.

Millions of Dollars in Potential Savings for Maryland

Four states do not currently provide state tax breaks for opportunity zone investments.

North Carolina passed legislation to decouple in 2018. Because they decoupled before the federal opportunity zone tax breaks started, the state doesn't have an exact measure of how much money has been saved. However, according to North Carolina General Assembly staff, they "generally informed members that the fiscal impact could be *significant*. We told them that the fiscal impact could increase significantly in the out-years because some of the tax breaks were not triggered until several years down the road."[8]

California, Massachusetts, and Mississippi base their state tax codes on pre-2017 versions of the federal tax code, which means that they don't give tax breaks for opportunity zones.

Maryland can retain millions of dollars to use for education or closing the deficit by ending the tax breaks for wealthy opportunity zone investors.

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[8] Email to Delegate Palakovich Carr on October 30, 2019.