Protect Michigan Revenues by Decoupling from Federal Opportunity Zones

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The 2017 Tax Cuts and Jobs Act introduced the Opportunity Zones program, providing tax breaks for wealthy investors who invest in designated zones. Gov. Rick Snyder selected 288 eligible census tracts that had, on average, higher poverty rates and lower family incomes than eligible but unselected tracts.

Federal Opportunity Zones offer three tax incentives for investors:

1

Temporary tax deferral. Investors who place existing assets with capital gains in a Qualified OZ Fund will not owe taxes on the gains from the original investment until 2026.

2

Permanent tax exclusion. In addition to the deferral, investors will not pay taxes on capital gains from the OZ investment as long as the investment is held for at least ten years.

3

Tax reduction. Capital gains left in Qualified OZ Funds for at least five years will benefit from a base increase of 10-15%, reducing taxes owed on the original investment.

LEAGUE RECOMMENDATION: PROTECT STATE REVENUE

Although the tax incentives are part of the federal tax code, they have important implications for Michigan taxpayers. Because taxpayers report their federal gross income when filing taxes in Michigan, these tax incentives actually reduce the income reported and the taxes owed in Michigan regardless of the location of the investment. A Michigan taxpayer who invests in an Opportunity Zone in California will see their Michigan tax bill reduced as a result of the program even though no Michigan community benefited from the investment.

Other states have already made efforts to rectify this problem. Both North Carolina and New York passed legislation decoupling from federal OZ provisions, disallowing tax deferral, reduction or exclusion of capital gains from OZ investments on state taxes. Two states, Arkansas and Hawaii, adopted federal OZ provisions but redefined Opportunity Zones to apply only to OZ census tracts within the state, thereby eliminating the risk of lost revenue for investments in other states.

Michigan does not currently have a cost estimate for the state revenues being lost through the Opportunity Zone tax breaks. A handful of other states have attempted to quantify the losses, including Wisconsin, which estimated $10 million in losses in 2019. Michigan can protect state revenue by **decoupling from federal Opportunity Zone provisions**.

LEAGUE RECOMMENDATION: INCREASE TRANSPARENCY

In addition to the lack of information about revenue losses, Michiganders have almost no information about how Opportunity Zone investments are being used in our communities. Despite having 288 zones throughout the state, official sources have only limited information about four investments throughout the state.

Early evidence from IRS data suggests approximately 60% of Detroit Opportunity Zones have seen OZ investments worth nearly $5,000 per resident. Missing is information about the types of investments—commercial or residential, in existing businesses or as part of new development projects—as well as the community impacts. Collecting state data will both increase transparency and oversight concerning the use of taxpayer dollars and help state agencies, community groups and other stakeholders attract investment to projects serving community needs. Michigan can make the most of the federal program, without costing taxpayers, by **introducing state reporting requirements**.