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AMERICANS FOR TaxFairness

How Tax Fairness Can Promote Racial Equity

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INTRODUCTION

The racial wealth gap in the United States is the result of over a century of policy decisions that have favored white taxpayers, millionaires, and corporations.

In light of our nation's history on many other government services, functions, and responsibilities – including redlining, denied access to our democracy, a stacked criminal justice system, and unequal public education – it should come as no surprise that our tax code, and the lack of enforcement of it, has harmed Black, Brown and Indigenous taxpayers while elevating white families. Like other aspects of our society, our tax system has perpetuated white privilege and hindered upward mobility for people of color.

The racial wealth gap has become wider during the past couple of decades as significant economic events such as the Great Recession and the COVID-19 pandemic have drastically shifted wealth towards the well-off, at the expense of the poor. For example, the median wealth gap between Black and white households rose from $172,00 in 2019 to over $214,000 in 2022. Similarly, homeownership has not worked to build wealth for Black homeowners to the same extent that it has for white homeowners, due to factors such as bias in home appraisals and a regressive property tax system. Divergent socioeconomic realities make what comes after the upcoming expiration of key provisions of the Tax Cuts and Jobs Act (TCJA) even more critical to addressing the racial wealth gap. Similar to the monumental investments in infrastructure in the Bipartisan Infrastructure Law and climate solutions in the Inflation Reduction Act, we now have a once-in-a-generation opportunity to achieve a more equitable tax system and change the trajectory of racial wealth inequality.

An equitable tax system does two things:

1. ***Narrows the racial wealth gap*** from the bottom up, and
2. ***Spurs economic mobility for Black, Brown and Indigenous individuals*** and families in each of the lower quintiles for both income and wealth.

Addressing the windfalls enjoyed by white taxpayers, the ultra-wealthy, and corporations will require a nuanced policy strategy that both curbs the accumulation of wealth for those at the top by addressing manipulation, favoritism, and lack of enforcement, and empowers financial growth and development for those at other steps on the income and wealth ladders. Tax policy should better serve the current economic realities of Black, Brown and Indigenous taxpayers and households, both in terms of how they earn and how they spend.

This document is intended to outline the provisions within our current tax system that have exacerbated the racial wealth gap and stymied upward economic mobility for people of color. The suggestions herein are tailored to highlight the harm-reduction efforts needed to stop the massive accumulation of benefits flowing to wealthy individuals and corporations through current tax policy and provide an overview of minimum policies to begin to address racial inequities caused by the historic benefits that our current system has bestowed on white taxpayers.

More Effectively **Tax Wealth**, Which is Largely Held By White People

- How, what, and who the federal government taxes has a big impact on the distribution of wealth and power in our society. In its current form, federal tax policy gives preference to wealth over work, meaning it favors those who already hold wealth over those trying to build it.

- Most people in this country earn money through paychecks, which is income from work. However, the very rich and those with generational wealth do not get most of their money from working; they make money off the money and assets they already have which is called "wealth."

- Because most working people have to spend most or all of their income to pay for basic necessities, it's extremely hard to build wealth. But for a fortunate few, there's a quick and easy way to build wealth: inherit it. Inheritance and gift transfers are disproportionately received by white households compared to their Black counterparts. When Black people do inherit wealth, both the mean and median amounts are smaller than their white counterparts.

- Once wealth starts to grow, the growth tends to accelerate: more money makes more money. The more time wealth has to grow, the greater the wealth and the power that comes with it.

- Wealth that passes between generations has the most time to grow and therefore becomes the largest, and for the first time the amount of wealth inherited by new billionaires was greater than the amount of wealth generated through entrepreneurship. **This wealth is not currently being taxed at the same rate that income from work is being taxed, which allows it to grow at an even more accelerated rate**. This gives more economic and societal power to those with generational wealth.

- Such economic dynasties with significant generational wealth in the United States are overwhelmingly white. Because they are not paying taxes at the same rate as working people pay on their paychecks, the tax system is currently considered "upside down" in that it's giving preferential treatment to the wealth of economic dynasties over the income most people earn through their paycheck. If we reformed the tax code by increasing the taxes that the very rich pay, not only would our immediate taxation system be more fair, greater revenue could be available for public investments promoting the economic security and wealth-building of Black, Brown and other communities of color.

- Reforming our tax system to more effectively tax wealth and the income generated by wealth, within and between generations, will raise the revenue we need to build an economy that works for everyone, not just the people at the top.

Address Tax-Code Features That Support Racial Inequity by Favoring Wealth Over Work

- Billionaires—who are almost exclusively white—can go years without paying taxes because our system isn't set up to properly tax huge wealth, or the income that flows from it. That our system isn't set up to tax the type of income that billionaires earn means that poor and working class people pay a higher rate of payroll taxes than those with income of a million dollars and more. And the wealthy pay a lower top tax rate on their profits from investments, or capital gains, than workers do on their wages.

- Capital gains income–the profit generated when an investment becomes more valuable than its purchase price– is taxed at a far lower rate than work income. The top capital gains tax rate is 20%, while the top rate on work income is 37%. The vast majority (92%) of this preferential treatment for investment income over work income flows to white households, even though they make up only two-thirds of taxpayers. (Meanwhile the very wealthiest investors are able to avoid even this 20% tax on their investment income—discussed more below.)

- This discount means, for instance, a white millionaire investor could pay a tax rate barely half what a Black lawyer or doctor would pay on the same income.

- The estate tax is the only federal curb on the accumulation of dynastic wealth: it taxes the transfer of family fortunes between generations. But it has been severely weakened over the past few decades. These changes have allowed large fortunes—which reside almost exclusively in white families—to grow even larger over the generations, further widening the racial wealth gap.

- By reducing taxable income, tax deductions indirectly lower taxes. Some of the most popular deductions—those for mortgage interest, college savings plans and retirement accounts—disproportionately benefit the mostly white wealthy who already have the money to buy a house and save for college and retirement. For example, white households receive over three-quarters of the benefit of the mortgage interest deduction.

- By reducing current or future taxes, tax-favored retirement-savings accounts—such as 401(k)s and Individual Retirement Arrangements (IRAs)—encourage workers to save for their golden years. Over two-thirds of white workers have tax-favored retirement-savings accounts, vs. less than half of Black workers and only about one-third of Latino workers. The accounts of white workers are on average more than five times bigger than those of Black and Latino workers.

- Donations to charity are tax-deductible. Over 90% of the tax benefit of charitable contributions is enjoyed by white households, despite Black households giving away a larger share of their income to charitable causes.

- The pass-through income deduction allows business owners to exclude 20% of their income before figuring their taxes. Nine out of 10 dollars in savings from this tax break goes to white business owners.

- Black families are audited at roughly 3 to 5 times the rate of non-Black households. A big focus of the audits of Black taxpayers is the Earned Income Tax Credit (EITC); among households of all races receiving the EITC, Black households are roughly 3 to 4 times more likely to be audited. One possible explanation for this is the disproportionate reliance on storefront tax preparation companies whose business model preys on Black, Latino, and low-income communities and whose services are notoriously inadequate.

- Part of the reason the IRS has focused enforcement on households receiving EITC is that they've lacked the resources to go after wealthy tax cheats, who file much more complicated returns and have the support of expensive legal and accounting professionals.

Pass Tax-Code Reforms That Would Promote Greater Racial Equity

Taxing wealth more like work would narrow wealth and income gaps between white households and those of color while raising revenue to invest in an economy that serves everyone, not just those at the top.

Necessary reforms would:

- ***Equalize the tax rates*** for investment income and work income, eliminating the discount that allows wealthy investors to pay a far lower rate on their income than workers do on theirs.
- ***More accurately tax the income*** generated by wealth by assessing capital gains income taxes on the wealthiest households annually, instead of only after an investment is sold.
- ***Target deductions*** **-** like those for mortgage interest, college savings plans, and retirement accounts - to better benefit account holders with lower value homes and savings for college and retirement; to stem windfalls at the top, these benefits can taper off and stop altogether for the very wealthy.
- ***Adjust the charitable contributions deduction*** to either be a credit for households under a certain income threshold, or a deduction that can be taken on top of the standard deduction.
- The current pass-through income deduction that primarily benefits hedge funds and other big businesses should be allowed to expire, which would ***save revenue that could be used to support solopreneurs*** and other small business owners under a certain income level.

Both the Biden-Harris administration and Senate Finance Committee Chairman Ron Wyden have offered proposals to address wealth inequality and the racial wealth gap: the Billionaire Minimum Income Tax (BMIT) and the Billionaire Income Tax (BIT), respectively.

- Both proposals would only apply to the very wealthiest households in the country, ensuring those fortunate few pay income taxes on all of their sources of income, including income in the form of the increased value of their investments.
- Right now, that kind of capital-gain income is only taxed if the investments are sold; if the investments are held until death, the gain in their value can escape taxation altogether. But the ultra-wealthy don't need to sell their investments to tap into that income because they can simply borrow at low rates against their growing wealth.
- These proposals would each raise more than $500 billion over 10 years, money that could fund healthcare, education, housing and other investments to help raise up communities of color.

We need to defend the restored funding for the Internal Revenue Service included in the Inflation Reduction Act of 2022 enacted by President Biden and Congressional Democrats.

- It will give the IRS the resources it needs to crack down on wealthy and corporate tax cheats.
- The IRS will not use the increased funding to increase tax enforcement on anyone making less than $400,000 a year.
- It will improve customer service so phone calls are answered and refunds issued more quickly.
- It will potentially improve and expand the Direct File program, saving more taxpayers a significant amount of time and money on tax preparation.
- As originally authorized, the increased IRS funding would raise a net $100 billion over 10 years by better ensuring the rich and corporations pay all the tax they legally owe.
- To shield their rich tax-evading supporters, Congressional Republicans have already begun to attack the restored funding for the IRS funding, clawing back some of that funding as part of the 2023 debt-ceiling agreement.
- Advocates for tax fairness and racial equity should work together to protect the restored IRS funding from further GOP attack.