Tax Alliance *for* ECONOMIC MOBILITY

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THE TAX CODE AND THE RACIAL WEALTH DIVIDE

Inequities in the U.S. Tax Code

The U.S. tax code is the largest asset-building tool available to our nation's households.[1] It is a vehicle by which the government helps families build savings and accumulate assets, ultimately creating financial security. Overall, it is moderately progressive, so it modestly shrinks income and wealth gaps. At the same time, though, key features of the tax code drive income and wealth inequality by targeting most of its benefits to wealthy families.[2]

This lack of support for lower-income households translates to households of color being largely excluded from tax benefits. The IRS does not collect data by race, but recent research from Prosperity Now and other members of the Tax Alliance shows that tax benefits skew heavily towards wealthy White households.[3] The 2017 tax law did little to make the tax code more equitable. In fact, the 2017 tax law will only deepen America's racial wealth divide, leaving behind people of color, as well as women and children.

In addition, IRS enforcement resources have shifted from high-income taxpayers and corporations to Earned Income Tax Credit (EITC) recipients, disproportionately burdening low-income people of color. The share of returns that the IRS audits has fallen dramatically since 2011, but it has fallen more steeply for the wealthy.[4]

Tax Code Snapshot

1. Many tax breaks in the U.S. tax code that are intended to promote economic opportunity instead largely fail to support lower-income households and communities of color, as these tax benefits skew towards wealthy, White households.

2. The 2017 tax law widens this disparity by directing tax cuts to White households and rewarding wealth over work.

3. In the long term, the new tax law could lead to funding cuts in services that help communities of color, deepening the racial wealth divide.

4. To make the tax code more equitable, policymakers should strengthen tax credits for low-income households, improve retirement and higher education tax incentives, and reform the MID.

Impacts of the 2017 Tax Law

Analysis of the TCJA's impacts shows that the new law continues to primarily benefit high-income, high-wealth individuals. Out of nearly $275 billion within the TCJA in 2018, $200 billion (72%) went to the top 20% of households, earning $110,000 or more.[5] White families are three times more likely than Black or Latino families to be among the country's top earners, so households of color receive far fewer benefits from the TCJA than White households do. In fact, 80% of the dollars within the TCJA that reached individuals in 2018 went to White households. On average, White households received $2,020 in tax cuts, while Latino households received $970 and Black households received $840.[6] One reason for this large disparity in average tax cuts is that Black and Latino families are overrepresented in the low-to-moderate income group in the U.S., relative to their share of the population, because of past policy choices affected by racism, combined with continuing racial bias and discrimination, that have placed barriers to economic opportunity in front of these households.

Another reason the TCJA perpetuates racial inequities is the fact that it rewards wealth over work. White taxpayers have higher average incomes, and more of their income comes from business activities, corporate stocks and investments, compared to people of color. These types of income are typically taxed at a lower rate than traditional income from labor. Several elements of the TCJA, such as a large corporate tax rate reduction and a cut to the estate tax, further shift the tax code's benefits to wealthy, mostly White households.

The TCJA also eliminated the CTC for 1 million children in low-income working families because they lack a Social Security number. These children are overwhelmingly "Dreamers" with undocumented status whose parents brought them to the United States. Further, the law contained a number of provisions, such as its international tax changes, that could lead to businesses outsourcing investment and jobs in ways that squeeze wages and worsen working conditions for low- and moderate-income working families. This would disproportionately hurt workers of color, who, due to decades of policy choices and continuing discrimination, are overrepresented among the ranks of those working for low wages.

Ultimately, the tax cuts from the TCJA could have far-reaching consequences for communities of color. Higher deficits brought on by the new law could lead to cuts in funding for programs and services that help low- and moderate-income households, as well as people of color, in areas like health, income security, job training and education. This, coupled with the inequitable distribution of benefits in the tax code, would only exacerbate the racial wealth divide in America.

Ways to Improve the Tax Code

There are several steps policymakers can take to make the tax code more equitable and favorable to lower-income households, particularly households of color. For one, existing tax credits that provide support to low-income workers should be strengthened. The Earned Income Tax Credit and Child Tax Credit, which have proven successful in helping low- and moderate-income households, should be expanded to workers who are currently excluded or who receive small benefits.[7] The Child Tax Credit should also be made fully refundable. Similarly, credits like the Child and Dependent Care Tax Credit and the Saver's Credit should be made refundable, which would allow more taxpayers to take full advantage of the benefits they provide. Moreover, the IRS should put its primary audit focus where it belongs — on wealthy individuals and large corporations, where the returns from audits are the greatest — rather than overemphasizing audits of low-income EITC recipients. Adequately funding IRS enforcement initiatives, which would allow the IRS to conduct more thorough audits of high-income filers and corporations, would help with this.

Reforms should also be made to the Mortgage Interest Deduction (MID), one of the largest tools the federal government uses to invest in homeownership.[8] As it stands, the MID primarily benefits existing homeowners and encourages wealthy individuals to take out larger mortgages. The 2017 tax law tilted the benefits of the MID even more towards already high-wealth households. The MID's focus should shift instead to providing relief to cost-burdened renters, as well as assisting first-time homebuyers. These reforms would be particularly beneficial to people of color and single women, who currently receive little support from the MID due to their lower homeownership rate. As homeownership is one of the main paths to building wealth in the U.S., a more equitable distribution of housing tax benefits could contribute to bridging the racial wealth gap.

Other ways to improve the tax code include reforming retirement[9] and higher education tax incentives[10] to support lower-income individuals and people of color, rather than wealthy individuals who need them the least. Finally, there should be a greater emphasis on rewarding income gained through labor, not investment, which would ensure that the distribution of tax benefits is not skewed to wealthy, White households.

***Resources*:**

- Meg Wiehe, Emanuel Nieves, Jeremie Greer and David Newville, *Race, Wealth and Taxes: How the Tax Cuts and Jobs Act Supercharges the Racial Wealth Divide*, Institute on Taxation and Economic Policy and Prosperity Now, October 2018, https://prosperitynow.org/resources/race-wealth-and-taxes.
- Lewis Brown Jr. and Heather McCulloch, *Building an Equitable Tax Code: A Primer for Advocates*, PolicyLink, July 2014, http://www.policylink.org/resources-tools/building-an-equitable-tax-code.
- Darrick Hamilton and Michael Linden, *Hidden Rules of Race are Embedded in the New Tax Law*, Roosevelt Institute, May 2018, http://rooseveltinstitute.org/hidden-rules-new-tax-law/.

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[1] Ezra Levin, Jeremie Greer and Ida Rademacher, "*From Upside Down to Right-Side Up: Redeploying $540 Billion in Federal Spending to Help All Families Save, Invest and Build Wealth*," (Washington, DC: Prosperity Now, 2014).
[2] Ibid.
[3] Meg Wiehe, Emanuel Nieves, Jeremie Greer and David Newville, "*Race, Wealth and Taxes: How the Tax Cuts and Jobs Act Supercharges the Racial Wealth Divide*," (Washington, DC: ITEP, Prosperity Now, 2018).
[4] Paul Kiel and Hannah Fresques, "*Where in The U.S. Are You Most Likely to Be Audited by the IRS*," (Washington, DC: ProPublica, 2019).
[5] Wiehe et al., 4.
[6] Ibid, 6.
[7] Tax Alliance for Economic Mobility, "*Policy Principles: Tax Credits for Low-Income Workers*," (Washington, DC: Tax Alliance for Economic Mobility, 2019).
[8] Tax Alliance for Economic Mobility, "*Policy Reforms: Homeownership and Housing*," (Washington, DC: Tax Alliance for Economic Mobility, 2019).
[9] Tax Alliance for Economic Mobility, "*Principles for Reform: Retirement Savings Tax Expenditures*," (Washington, DC: Tax Alliance for Economic Mobility, 2016).
[10] Tax Alliance for Economic Mobility, "*Principles for Reform: Higher Education & College Savings Tax Expenditures*," (Washington, DC: Tax Alliance for Economic Mobility, 2016).