INSIGHT
Center for Community Economic Development

FactSheet

Helping People and Communities Become, and Remain, Economically Secure

THE RACIAL GAP IN TAX POLICY

Introduction

Taxes are an investment we make in each other and in our nation. The economic prospects of various segments of the population can be determined by looking at our tax code. Within this code lies our nation's wealth DNA, exerting a profound influence on whose wealth grows and whose wealth lies dormant.

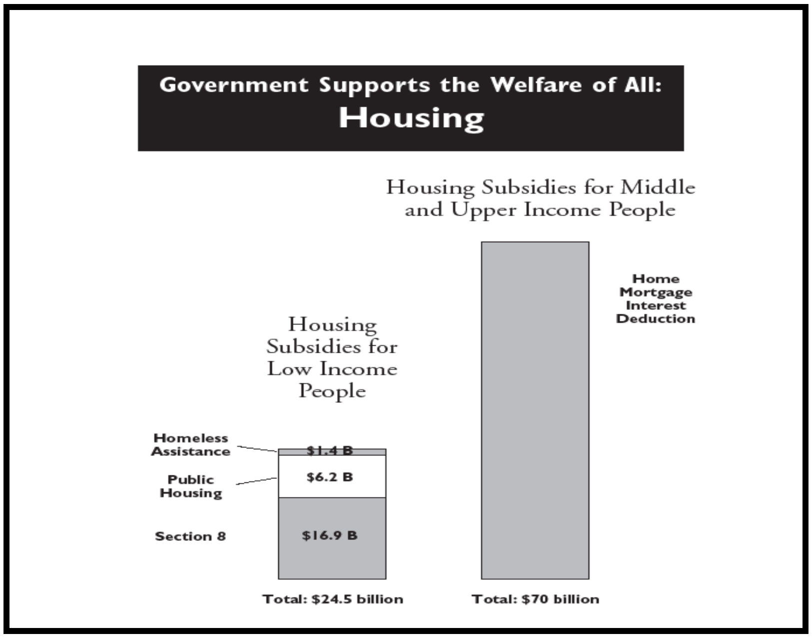
Throughout US history, tax policy has been used as a mechanism of wealth redistribution from people of color to white people. In the mid-1800s when people flocked to California during the gold rush, special taxes were levied on Chinese miners and laundries, inhibiting their capacity to build wealth. Taxes paid by Chinese accounted for 25% of California's taxes between 1850 and 1870, but the Chinese, unable to become citizens, did not receive tax funded services. Poll taxes only on African Americans prevented them from voting for nearly 100 years. In some Southern states constitutional limits were placed on property taxes in order to keep Black schools under-funded and the population undereducated; the Alabama law still exists.[1] While Latino and other immigrants pay taxes, they are not eligible for tax-funded benefits. For example, undocumented children - even valedictorian high school graduates - have been barred from going to public universities at the in-state tuition rates. In Indian country, tribal governments have been prevented from using their natural land resources for their own betterment and are legally tax-exempt. But recently, just as tribes are finding ways to develop business enterprises on their reservations, new policies are being passed to require them to share their financial resources.[2]

It is appropriate to use tax policy as a way to subsidize and incent asset building activities. For example, the Home Mortgage Interest Deduction was originally designed to encourage homeownership among lower income people. However, these policies must be re-examined to decide whether they meet our national concerns about growing economic inequality.

How the Tax Code Promotes Wealth Inequality

More recently, asset building incentives in the tax code have served to increase the racial wealth gap: between 1995 and 2001, the average non-white family saw its net worth fall by 7%, while white wealth grew 37%.[3]

In 2005 (the most recent data available), the federal government devoted $367 billion to asset-building incentives.[4] For every $1 in the federal budget spent directly on asset programs for low-income people, $582 in tax deductions, preferential rates, exemptions, and credits were given up; 99% of the federal asset building budget is delivered through the tax code via these means, called tax expenditures.[5] These provisions allow people to keep dollars that would otherwise be put into the nation's tax box. Many of these subsidies are theoretically universal, and there are a few specifically aimed at the middle class and the poor. In practice, however, the major beneficiaries are those who already have the most assets. Looking only at the three largest asset building policies—the home mortgage interest deduction, the property tax deduction, and preferential rates on capital gains and dividends—households with average incomes of $1.25 million receive 45% of the subsidies or $169,150 on average per household. In contrast, households with incomes of $17,000 or less get, on average, $3 in benefits.[6] Tax and budget decisions have subsidized the rich far more than the poor. (See example in chart below).



Source: Joint Committee on Taxation: Department of Housing and Urban Development. All numbers are from FY 2005.

- The Home Mortgage Interest Deduction which can be claimed for homes costing up to one million dollars has contributed to the purchase of larger and larger home by families that already own homes, with the side effect of an excessive development of oversized homes for this market.
- Low-wage workers who are disproportionately people of color are less likely to have employer-sponsored retirement accounts and therefore do not benefit widely from pre-tax retirement contributions.
- Tax-free saving for college tuition is permitted under federal and some state policies. Because lower income people have lower tax rates, the tax saving that comes from a 529 or Coverdell account is small and unlikely to induce saving. In contrast, middle- and upper-income people who can put aside tens of thousands of dollars for their children receive meaningful tax breaks. [7]
- Some states have actively sought to burden people of color (hurting all lower-income people) with regressive taxes that have perpetuated and deepened racial and wealth disparities. For example, many states rely heavily on sales taxes including on basic needs such as food and clothing.

Helping People Build Wealth Grows Our Economy

Helping taxpayers build wealth has positive effects on families, communities, and the economy. Asset ownership helps families save, invest, start businesses, plan for retirement, and buy homes. Directing these asset building policies and programs to those with low assets would rebuild our shrinking middle class and help more people achieve economic security. Promoting increased retirement savings for those who already have accounts or subsidizing homeownership among those who enjoy stable housing does not enhance widespread economic success. Indeed, disparities impair economic growth.

Recommendations

The time is ripe to increase the transparency of tax expenditure effects beyond income alone, to make visible the effects of race, gender, family status, and age. With better information, there would be greater understanding and engagement of all constituencies in shaping policy to foster wealth building for those historically and currently side-lined from economic opportunity.

The tax code can be a tool with which to close the racial wealth gap. Reforms that would benefit all low-income taxpayers include:

1. *Build the capacity to analyze the tax code for racial effects.* Presently, it is very difficult to examine the federal tax code's wealth building provisions by key demographic groups like race, gender, and family status. By building the capacity to create imputed demographic data variables and combining these variables with income data, we would have evidence of the impacts by population characteristics on the effectiveness of the government's wealth building policies. This data would not only let policy makers know if resources need to be re-directed to expand economic security and opportunity, but also would let them know where they need to be directed.

2. *Preserve the estate tax*. Our nation's most progressive tax on the descendents of those who have gained the most benefit from our society. The revenues – up to one trillion over the next decade - should be earmarked for innovative strategies that help seed wealth for the next generation. Because wealth can be influenced by savings, financial literacy, and educational opportunity, it makes sense that this revenue could be set aside to fund these measures. For example, estate tax revenue could be used to support matching savings programs that participants will use to pay for college, start a business, purchase a home, etc. The revenue could also be targeted toward more direct support of educational opportunity, such as in funding universal early education or by closing gaps in financial aid for post-secondary students.

3. *Analyze and reform the tax expenditure provisions*. Asset building benefits could be directed to low-income families and families of color who currently have few or no assets. For example:
   - Convert existing tax incentives into uniform refundable tax credits, which are more effective and equitable mechanisms for encouraging socially desirable behaviors.[8]
   - Cap the benefits that any household can receive.

4. *Lower the cap on the Home Mortgage Interest Deduction* to area median housing value, making it available only on interest owed on the primary residence, and/or making it refundable so that lower income homeowners can take full advantage of the benefit, and/or instituting a flat refundable mortgage credit on the median mortgage. A renter's credit would enable savings for non-homeowners.

5. *Use federal allocations as financial incentives for the revision of inequitable state tax systems.* Any and all options should be reviewed and explored to link federal aid to states with long-term revisions in state revenue systems. States with tax codes that are vestiges of a bygone era designed to curtail opportunity for people of color should be encouraged to create equitable systems that do not put unfair burdens on poor and minority taxpayers.

The Insight Center for Community Economic Development is a national research, consulting and legal organization dedicated to building economic health in disenfranchised communities.

This factsheet was produced as part of our Closing the Racial Wealth Gap Initiative, a national effort to close the racial wealth gap for the next generation by injecting over 140 members of the Experts of Color Network into the national debate on America's future. Experts on this issue include Don Baylor, Rebecca Dixon, Lillian Beadsie Woo, Meizhu Lui, and Jackie Lynn Coleman, all members of the Experts of Color Network.

For more information please visit www.racialwealthgap.org and www.expertsofcolor.org.

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[1] Einhorn, Robin, "Tax Aversion: The Legacy of Slavery," *Poverty and Race,* March/April 2008
[2] Lui, Meizhu, B. Robles, B. Leondar-Wright, R. Brewer, R. Adamson, *The Color of Wealth: The Story Behind the U.S. Racial Wealth Divide,* The New Press, New York, 2006, pp. 67-68.
[3] Oliver and Shapiro, *Black Wealth White Wealth,* [3] (1997), New York, NY: Routledge
[4] L. Woo and D. Buchholz. (2007). *Return on Investment? Getting more from federal asset-building policies*. (Washington, DC: CFED), p.1. This conservative estimate of the federal asset-building budget includes only four categories of assets (homeownership, savings and investment, retirement accounts, and small business development) that are aimed at individuals and families. For a complete description of the programs included and the selection criteria, please see: http://www.cfed.org/think.m?id=112&pubid=177.
[5] Ibid., p. 9
[6] Ibid., p. 7
[7] Dynarski, S. (2004). *Who Benefits from the Education Saving Incentives? Income, Educational Expectations, and the Value of the 529 and Coverdell*. (NEBR Working Paper No. 10470). Cambridge: National Bureau of Economic Research.
[8] F. Goldberg, L. Batchelder, and P. Orszag. (2006). *Reforming Tax Incentives into Uniform Refundable Tax Credits.* Accessed 2/26/09 at http://www.brookings.edu/papers/2006/08taxes_orszag.aspx.