HIDDEN RULES OF RACE ARE EMBEDDED IN THE NEW TAX LAW

ISSUE BRIEF BY **DARRICK HAMILTON** AND **MICHAEL LINDEN** | MAY 2018

The federal tax code is one of the most powerful tools of economic policymaking. It can incentivize, subsidize, or discourage certain behaviors or activities. It can impose economic burdens, or it can relieve them. It can shift resources from one area to another. It can provide an implicit check on the outsized power, including political power, that is accrued by one class of people with a gross disproportion of societal resources, or it can reinforce and amplify that power. The federal tax code, in other words, houses some of most critical rules that govern our economy. As such, it is also home to a set of hidden racial rules that, through intention or neglect, provide opportunities to some communities and create barriers for others.

The hidden rules of race (Flynn et al. 2017) are the racial rules that reshape the economy, and society more broadly, for black and brown Americans. These rules—historic and current, implicit and explicit—have driven disparities ranging from wealth creation and educational attainment to health care access and economic mobility.

The recently enacted Tax Cuts and Jobs Act, known colloquially as the Trump tax law, was a substantial rewrite of the tax code. Far from addressing, fixing, or improving the hidden rules of the tax code that disadvantage people of color, the new law strengthened some of these rules and even added new ones. The sum total effect of the Trump tax law is likely to further increase the economic disparities, particularly with regards to wealth, between white Americans and communities of color.

There are at least four major ways in which the new tax law will have a disparate negative impact on people of color. First, the tax law's benefits accrue disproportionately to high-income households, which means that, because of the long-established racial income gaps, white households will capture more than their fair share of the tax cuts.

Second, the new law primarily benefits people who hold existing wealth—in everything from corporate shares to housing stock—rather than providing benefits to create wealth. Compared to *income* disparities, racial *wealth* disparities are more severe and generationally established, and thus they have a much more intense and lasting impact that the tax law will exacerbate.

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Third, the new law is likely to increase local fees and fines that disproportionately strip wealth from people of color. By limiting the state and local tax deduction, the law will push states and localities to rely more on fees and fines as sources of revenue. Not only are fees and fines more regressive sources of income, but they also extend the reach of a broken criminal justice system that causes enormous economic and civic damage within communities of color.

Finally, the enormous revenue loss caused by this law, coupled with the limitation on the state and local tax deduction, will undermine the public sector. This will be particularly true at the state and local levels where governments are often constrained to balance their budgets. At the federal level, the woeful irony of a budget-busting tax cut skewed towards the wealthy in a political context that overemphasizes austerity will likely mean an acceleration of the already dimensioned public sector labor force. Black workers make up a disproportionate share of public employees, and public employment plays a disproportionately important role in black communities. Cuts to public employment will therefore impose a disparate burden on black American workers and black American communities.

In sum, the Tax Cuts and Jobs Act enhances existing hidden rules and creates new ones that negatively impact people of color. The scale of the long-term impacts of these rules is yet to be determined, but the direction of that impact is clear: In addition to disadvantaging low- and middle-income people in favor of the rich and powerful few, the Trump tax law specifically preys upon people of color.

THE NEW TAX LAW IS SKEWED IN FAVOR OF HIGH-INCOME HOUSEHOLDS, DISADVANTAGING BLACK AND BROWN FAMILIES

The Tax Cuts and Jobs Act disproportionately benefits individuals and households at the high end of the income spectrum. The central elements of the new law—a large rate reduction for corporations, a new tax deduction for "qualified business income," lower personal income tax rates, a reduction in the Alternative Minimum Tax, and a large cut to the estate tax—all mainly benefit richer people. The result of these changes is very large tax cut for those at the top, compared to a modest tax cut for those in the middle, and almost no tax cut at all for those at the bottom.

According to the Tax Policy Center, for 2018, the average tax cut for the richest 1 percent is roughly 50 times larger, in raw dollars, than the average tax cut for someone in the middle quintile, and it's 850 times larger than the average tax cut for someone in the bottom quintile. Even as a share of income, the law's benefits skew toward those with high incomes.

The average household in the top 5 percent of income earners can expect to see their incomes rise by roughly 4 percent, which is twice the increase for someone in the middle quintile and about 10 times more than someone in the bottom quintile (Tax Policy Center 2018a). Moreover, households in the bottom quintile are significantly more likely to receive no tax cut at all compared to those at the top. Over 95 percent of all households in the top 5 percent will receive a tax cut, compared to only 53 percent of those in the bottom quintile (Tax Policy Center 2018b).

The law also becomes more skewed toward the rich over time, as certain provisions expire. By 2027, fully 83 percent of the tax cuts flow to those in the top 1 percent, while those in the bottom 60 percent will, on average, actually experience tax increases relative to the previous tax law (Tax Policy Center 2017).

The overall skew of the Trump tax law toward the rich is both well-covered by the media and well-known by the public. In a recent Quinnipiac University poll (2018), fully 62 percent of respondents agreed that the law mainly benefits the wealthy rather than the middle class. What is less well understood is the racial implications of this income skew.

The richest Americans are the disproportionate beneficiaries of the Trump tax law, and the richest Americans are also disproportionately white. According to the Current Population Survey (2016), while white households make up 67 percent of all households in the country, they constitute 78 percent of those in the richest 5 percent of income earners. Black households, on the other hand, make up 13 percent of all households but comprise just 5 percent of those in the top 5 percent. Similarly, Hispanic households are 13 percent of the total, but they account for just 6 percent of those in the top. On the other end of the income spectrum, both black households and Hispanic households are overrepresented in the bottom income quintile (United States Census Bureau 2016). Consequently, by cutting taxes for the rich, while mainly leaving out the poorest Americans from the tax changes entirely, the Trump tax law also very directly delivers disproportionate tax benefits to white Americans relative to Americans of color.

WEALTH IS EVEN MORE RACIALLY STRATIFIED THAN INCOME, AND THE NEW TAX LAW BENEFITS THOSE WITH EXISTING WEALTH

Compared to income, wealth is far more concentrated in the hands of a few, and the racial implications are even more lasting and damaging. Unfortunately, as with income, the new Trump tax law favors those with existing wealth over those who are striving to create new wealth and in so doing reinforces the destructive racial rules of wealth.

The richest 1 percent of Americans take home about 20 percent of all the income, but own about 40 percent of all the wealth (Saez and Zucman 2015). Moreover, the racial gaps in wealth are even starker than the income gaps. The median income for white households is roughly 65 percent higher than it is for black households (Pew Research Center 2016). Meanwhile, **median net worth among white households is about 1200 percent larger than it is among black households** (Pew Research Center 2016). Twenty percent of black families have no wealth at all, compared to only 9 percent of white families (Dettling 2017). Virtually all of the economic gains from the last four decades have accrued to households in the top 20 percent of the income distribution, a group that is overwhelmingly and disproportionately white (Hamilton and Famighetti 2017). This racial wealth inequality persists even after accounting for educational attainment. White families with a head of household who dropped out of high school have more wealth than black families with a head of household who finished college (Hamilton et al. 2015; Darity et al. 2018).

Wealth inequality—far more than income inequality—has a persistent negative effect on economic opportunity, mobility, and security. Households with wealth pass enormous economic advantages on to future generations that those without wealth can rarely, if ever, match. A child born into a family with wealth can often expect to enjoy debt-free higher education, help purchasing his or her first home, seed financing for starting a business, and the general comfort that comes from knowing there is a strong safety net to fall back on. Children without wealth benefit from none of these advantages. In fact, rather than receiving economic resources, adult children of parents without wealth are often called upon to provide resources for financially less well-off kin. Unlike income, wealth can be transferred directly from one generation to the next, cementing economic advantages—and disadvantages—across decades and even centuries.

The racial wealth gap is rooted in the history of chattel slavery, when black people themselves were considered capital assets that fueled the wealth of a white plantation owning class, which served as the impetus for modern financial capital markets (Baptist 2014). Since the abolition of slavery, public policies have mainly served to perpetuate the racial wealth gap. From redlining to mass incarceration to unregulated predatory lending, federal, state, and local policies have tended to erect barriers to wealth creation for black and brown people, while protecting and expanding the legacy of wealth that exists mainly in the accounts of white people.

The Tax Cuts and Jobs Act continues in that trend, favoring existing wealth over new wealth creation in numerous important ways. For example, one of the centerpieces of the new law is its massive tax cut for corporations, reducing their tax rate down from 35 percent to 21 percent. That one change alone is worth about $1.3 trillion over the next decade (Joint Committee on Taxation 2017). Tax cuts for corporations disproportionately benefit existing shareholders rather than workers or consumers. Despite baseless promises that the corporate tax cuts would translate into $4,000 wage increases, nearly all nonpartisan and official estimates suggest that even over the long run, roughly three-quarters of the benefits from Trump's corporate tax cuts flow to the owners of the corporations (Center on Budget and Policy Priorities 2017). Further, there is scant evidence that the presumed promise of "trickle-down" job creation from increased firm investment has ever been realized. What is clear is growing economic disparity in which all economic gains are being "hoarded" by the wealthy and professional classes (Reeves 2017). Indeed, corporations are already using the vast majority of their windfall tax savings to repurchase shares of their own stock (Egan 2018). These stock buybacks deliver enormous benefits to existing shareholders—an elite group, as the top 20 percent own 92 percent of all shareholder wealth. And of course, black and Latinx households are significantly less likely to own any stock than are white households (Gallup 2017).

Furthermore, despite being billed as a comprehensive "tax reform," the new tax law makes none of the potential changes one would expect to see out of a reform that sought to aid in new wealth creation, such as provisions for seed capital to create vehicles to assets that appreciate over time like a home or a new business (e.g. "baby bonds") (Hamilton and Darity 2010; Hamilton and Darity 2017b). Essentially, the law maintains all of the largest legacy tax benefits for existing wealth, such as the lower tax rates on capital gains.

On top of all this, the Trump tax law dramatically cuts the estate tax for the extremely wealthy—a group that is far whiter than the overall population—making it even easier to pass along their often inherited advantages to another generation of heirs (Jan 2017).[1] Even before the Trump tax law, estates worth up to $11 million could be passed on entirely tax-free, despite the fact that roughly half of the value in the largest estates has never been subject to income tax (Poterba and Weisbenner 2000). The new law increases the estate tax exemption, so now just estates worth more than $22 million owe any estate tax at all, bestowing an enormous tax windfall worth approximately $83 billion for only the wealthiest heirs in the country. This policy is especially galling considering that inheritance is the single variable with the greatest explanatory power of the overall racial wealth gap (Gittleman and Wolff 2004).

[1] While we do not have data on the racial demographics of Americans who owe estate taxes, two relevant data points make it a safe assertion that they are disproportionately white. First, as of 2015, only seven people on the Forbes 400 were either black or Latinx. Second, while over 15 percent of white households have a total net worth above $1 million, less than 2 percent of black or Hispanic households do.

TRUMP TAX LAW ENCOURAGES STATES AND LOCALITIES TO SHIFT THEIR REVENUE SOURCES TO MORE REGRESSIVE FEES AND FINES THAT ARE DISPROPORTIONATELY PAID BY COMMUNITIES OF COLOR

The new tax law contains a substantial provision that will likely incentivize states and localities to shift from progressive income taxes as a source of revenue and rely more heavily on regressive fees and fines. The Tax Cuts and Jobs Act substantially limited the ability to deduct one's state and local taxes from federal taxable income. Under the old tax code, the state and local tax (SALT) deduction allowed those who itemized their deductions to subtract from their taxable income any state and local taxes they paid. The state and local tax deduction served as a "revenue-sharing" mechanism whereby the federal government essentially forgoes some tax revenue and instead facilitates its collection by the state or local government (Leachman and Lav 2017).

In a tax system with a limited SALT deduction, states and localities may find it harder politically to raise revenue in a progressive way. We can see this scenario already playing out in New Jersey where *Democratic* state legislators who previously supported raising taxes on rich residents voiced concerns over a high-income surtax because that tax would no longer be fully deductible at the federal level (Marcus and Johnson 2018). When states and localities face revenue constraints, they often turn to fees and fines as a substitute.

Shifting from progressive income and property taxes to regressive fines and fees, along with the historical political vulnerability of the black community to state predation, is tantamount to shifting the tax burden from predominantly white residents to disproportionately black and brown residents. Also, this increased reliance on fees and fines will lead to increased interactions with the criminal justice system—as police, parole, probation, and other court officers respond to the imperative to raise revenue—an outcome that has negative implications for communities of color.

Even before the new tax law was enacted, states and localities were increasingly relying on fees and fines to generate revenue (Shapiro 2014). A report from the Brennan Center for Justice found that, "Across the board ... states are introducing new user fees, raising the dollar amounts of existing fees, and intensifying the collection of fees and other forms of criminal justice debt such as fines and restitution" (Bannon et al. 2010). This trend was spurred forward by the fiscal crunch during and immediately after the Great Recession, but the phenomenon is not limited to periods of massive fiscal upheaval. Multiple studies have shown that reduced tax revenue leads to higher fees and fines. For example, one study of North Carolina in the 1990s found that police issued more traffic tickets in years immediately following revenue declines (Garrett and Wagner 2009). Another study using data from Massachusetts in 2005 found evidence that "the likelihood and dollar amounts of fines are decreasing functions of local property tax revenue" (Makowsky and Stratmann 2009). In other words, when states and local governments need money, they often get it from court fees, speeding tickets, bail, and even forfeiture (Katzenstein and Waller 2015).

There is, of course, a disproportionate impact on communities of color from these types of criminal justice fees and fines. Most obviously and most directly, criminal justice fees and fines are regressive; they fall more heavily on poorer people than on richer people. A $1,000 fine is a much larger burden for a person who makes $20,000 a year than for someone who makes $200,000 a year. And because people of color tend to have, on average, lower incomes than white people, a shift from income taxes to fees and fines is a shift in the overall revenue burden from white people to people of color. The fees and fines often compound into debt traps that further impede closure of the racial wealth gap. And because of their economic and political marginalization, people of color tend to be less well-equipped to resist this policy shift from a progressive tax system to a regressive one that relies on fees and fines. It should come as no surprise, then, that cities with more black residents tend to have a greater reliance on fines as a source of revenue (Sances and You 2017).

A second, even more pernicious impact from shifting to more fees and fines is that the fiscal imperative to raise revenue from the criminal justice system is likely to cause more people of color to become ensnared in that system and to suffer the long-term consequences. For example, as noted above, revenue loss leads to more traffic stops, which will inevitably lead to more arrests. There is also evidence that the need for revenue influences other, more dramatic policing behavior, such as drug arrests, in order to increase asset forfeitures (Holcomb et al. 2011).

The racialized nature of the American criminal justice system is well documented (Alexander 2012). Blacks are more likely than whites to be pulled over by the police, to have their cars searched, to be arrested for drug crimes despite no evidence of greater use, to serve longer sentences, to be jailed while awaiting trial, and to lose the right to vote as a result of a felony. When confronted with an expensive legal system, blacks have far less income or wealth to address their exigent situation. Moreover, exposure to the criminal justice system has a more detrimental effect on black American wealth accumulation, and wealth itself does not protect blacks from incarceration to same extent as whites—the relatively few black youth from wealthy families face a greater risk of future incarceration than whites from wealth poor families (Zaw et al. 2016). For black people, far more than for white people, interaction with the criminal justice system is fraught with danger and potentially life-altering consequences.

Even what some would consider to be "minor" interactions with the criminal justice system can have lasting effects. For example, Professors Vesla Weaver and Amy Lerman (2010) show that "those with contact at every level of criminal supervision withdraw from political life—they are less likely to participate in civic groups, they are less likely to express their political voice in elections, and they are less trusting of government." Therefore, any policy that results in more of these "minor" interactions carry enormous negative impacts for communities of color, including the diminished democratic participation of these communities.

One might not immediately think of the newly passed tax law as contributing to the problems of mass incarceration and the racial disparities of our criminal justice system, but it will. By making it harder for states and localities to raise revenue in a progressive way, and by potentially undermining federal support for states and local governments, the law will encourage the increased use of fees and fines, which are both regressive and expand the reach of a broken justice system.

ENORMOUS REVENUE LOSS FROM THE TAX CUTS WILL DISPROPORTIONATELY IMPACT BLACK WORKERS

The Tax Cuts and Jobs Act is estimated to cost roughly $1.9 trillion in lost revenue over the course of the next decade (Congressional Budget Office 2018a). The total fiscal cost of the law could end up being much higher than that. To start with, the additional interest costs on the added debt incurred due to the new law will add another $300 billion in costs (Congressional Budget Office 2018b). Second, if the myriad temporary provisions in the law are permanently extended, that could add another $500 billion (Committee for a Responsible Federal Budget 2017). Finally, the new law offers ample opportunities for tax avoidance from high-income individuals and multinational corporations. It is very possible that the official cost estimates of the law have not fully accounted for the degree to which rich people will be able shield their income from taxation (Kamin et al. 2018).

The extent to which these costs will put true fiscal pressure on the federal budget is a topic for another issue brief. From a political economy standpoint, however, there can be little doubt that the significant increase in budget deficits, along with the attendant increase in publicly held debt, in a political context that overemphasizes austerity, will substantially increase the *perceived* fiscal pressure to reduce federal spending. Indeed, Congressional Republicans and President Trump have already begun calling for "entitlement reform" and cuts to a wide array of federal programs (Weixel 2017). And one group of people who are always directly impacted by "austerity" cuts are public sector employees. President Trump's budget proposal, for example, contains $65 billion in cuts to retirement benefits for the federal workforce (Office of Management and Budget 2018).

Furthermore, as discussed above, the limitation on the state and local tax deduction could make it harder for states and localities to raise the revenue they need to support public services. Even if they turn to regressive fees and fines, those sources of revenue are unlikely to counteract the potential revenue loss from lower income and property taxes. The combined effects of the SALT limitation and the massive revenue reduction at the federal level will put public-sector employment at grave risk.

When the public sector sheds jobs or trims benefits and wages, black people, and therefore black communities, bear a disproportionate share of that burden. That's because fully 1-in-5 black workers is employed in the public sector (Cohen 2015). As of 2014, 18 percent of all federal, full-time civilian employees were black, even though only 12 percent of the total labor force was black (Partnership for Public Service 2014). Historically, the public sector has been an important source of economic security and upward mobility for black workers. Beginning with President Franklin Roosevelt's executive order 8802 and culminating with President Lyndon Johnson's executive order 11246, the federal government slowly banned employment and contracting discrimination based on race, gender, or national origin and even required "affirmative action" to ensure that discrimination was not taking place (Flynn et al. 2016). As a result, over the last half century, public sector employment has offered higher wages, better benefits, and a smaller racial wage gap than the private sector in which individual employers and managers have greater discretion to discriminate (Pitts 2011).[2] For example, in the private sector, black workers' wages are, on average, about 13 percent lower than white workers', whereas in state and local public jobs, that gap is only about 2 percent (Cooper et al. 2012).

We need only look to the last decade to see the effects of so-called "austerity" cuts on black workers. During the Great Recession, tax revenues—already low at the federal level due to the "Bush Tax Cuts" of 2001 and 2003—further plunged as the financial collapse turned into a wider economic crisis. Soon enough, "supply-side" conservatives began pushing for massive cuts to government services and programs to bring spending down closer to the artificially low levels of revenue. Federal, state, and local governments proceeded to lay off about 600,000 workers from the end of the recession in 2009 to 2012 (Greenstone and Looney 2012). The result was what sociologist Jennifer Laird (2017) called a "post-recession double disadvantage for black public sector workers." Black workers, by being concentrated in the public sector, bore the brunt of the layoffs, and, even in the public sector, they were more likely than their white co-workers to lose their jobs (Laird 2017).

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[2] It is worth noting that there is an important gender interaction here as well, given that public sector employment has tended to have a smaller gender pay gap relative to the public sector, too. As a result, the public sector is especially critical for women of color.

It is too soon to say for sure whether President Trump's new tax law will result in similar so-called public sector "belt-tightening" that will especially squeeze black workers. Indeed, the very first federal spending bill passed by Congress after the enactment of the new tax law actually increased domestic funding. However, the experience of the 2001 and 2003 tax cuts should worry us. Those tax cuts did not immediately result in public sector layoffs either. It was only in 2009, with the election of a new president, that conservatives rediscovered their concern for "fiscal responsibility" and forced massive cuts that resulted in hundreds of thousands of job losses.

Whether by increasing the pressure for spending "austerity" or by limiting the ability of state and local governments to raise revenue on their own, the new Trump tax law is likely to undermine public-sector employment and benefits—and millions of black workers along with it.

TOWARD A MORE INCLUSIVE TAX POLICY

There is no doubt that there are even more hidden rules of race in the Tax Cuts and Jobs Act in addition to the ones described above. For example, the law will result in 13 million more people without health insurance, a consequence that will certainly have a disparate impact on the health and economic well-being of communities of color. Furthermore, the law's tax incentives for corporations to shift operations overseas will likely continue the existing downward trend in manufacturing employment, a sector in which Latinx workers, in particular, have historically been overrepresented. And the discussion above barely touches on the important interactions between gender and race, interactions which will also play out in critical and damaging ways for women of color, especially.

But the racial penalties and barriers embedded within this new tax law also perversely point the way toward a more inclusive federal tax policy, one in which the hidden rules encourage rather than discourage an economy that works for communities of color. Such a tax code would begin by dramatically enhancing progressivity, rather than reducing it. For example, wealthy corporations should be paying more in taxes, not less, and the top income tax rate for the very richest should be higher, not lower. Second, the tax code should actively seek out ways to redress wealth inequality, not just income inequality. This could take the form of a much more robust estate tax, higher capital gains taxes, or even a wealth tax. It should also seek out ways to help those born without wealth build it. For example, "baby bonds," originally proposed by Professors William Darity Jr. and Darrick Hamilton (co-author of this brief), would be federally managed trust accounts established at birth to serve as financial capital for the future down payment of a home, to start a new business, or to purchase a debt-free higher education for when the child matures to adulthood (Hamilton and Darity 2010). Instead of preferencing existing wealth, the tax system could be used to capitalize these accounts and help people build wealth within them.

Federal tax policy should also support employment for people of color, not create new barriers or undermine existing sectors that provide good jobs at fair wages. And finally, the tax code should make the use of criminal justice fees and fines as sources of revenue less attractive, not incentivize it. That could mean more revenue sharing between the federal government and states and localities.

Before the Trump tax law, there were myriad ways that federal tax policy could have been improved to remove the hidden and not-so-hidden barriers to economic opportunity and security for people of color embedded in the tax code. Unfortunately, the new law will deliver bigger benefits and more advantages to wealthy white households relative to households of color, while simultaneously strengthening existing racial barriers to a truly inclusive economy. Only with progressive tax policy can the hidden rules of race that shape the federal tax code, the U.S. economy, and society at large begin to be undone.

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