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Practitioner Essay

Turning the U.S. Tax Code from Upside Down to Right-Side Up Can Close the Racial Wealth Gap

Jeremie Greer, Jane Duong, and Ezra Levin

Abstract

Over the past twenty years, the federal government has spent more than $8 trillion through the tax code to help households save, invest, and build wealth. However, an overwhelming majority of this tax spending has gone to the wealthiest Americans who hardly need the support to build more wealth. Since 1994, the federal government's massive spending on asset building has more than doubled, and there are no signs of it slowing down. This upside-down tax system perpetuates the widespread wealth inequality we are seeing in this country, and it exacerbates the racial wealth gap that is holding back so many Asian Americans and Pacific Islanders (AAPIs) and other households of color.

This paper will (1) illustrate how the tax code plays a role in widening the racial wealth gap for AAPIs and other communities of color, (2) explain how current asset-building tax programs are missing an opportunity to boost the wealth of low-income AAPIs and other communities of color, and (3) propose legislative action to create a more equitable and progressive tax code for all.

Introduction

The economic topics of the day are inequality and opportunity. In his seminal book, *Capital in the Twenty-First Century*, French economist Thomas Piketty found that the unequal distribution of wealth is a driving force behind growing income inequality (Piketty and Goldhammer, 2014). In the United States, the Pew Research Center examined data from the 2013 Survey of Consumer Finances and found that median net worth for upper-income families is almost seven times the net worth of middle-income families and nearly seventy times that of low-income families (Fry and Kochhar, 2014). This is the widest wealth gap recorded in the United States in the last thirty years.

Even more troubling is the rapidly growing racial wealth gap. According to Pew, white net worth is thirteen times higher than that of blacks and ten times greater than Hispanics, with Asian Americans and Pacific Islanders (AAPIs) continuing to lag behind whites with evidence showing this gap growing wider (Kochhar and Fry, 2014; Kochhar, Fry, and Taylor, 2011). Further evidence shows that major portions of the AAPI community continue to live in poverty with little to no assets (Ishimatsu, 2013).

Historically, the federal government has played an important role in helping families build wealth and assets. This role is played mainly through the U.S. tax code, which helps American households build and preserve their wealth with tax benefits that support retirement savings, investments, education, and home ownership.

Government has a role to play because of the strong link between wealth and economic opportunity. Research shows that even modest liquid savings allow families to overcome the negative effects of income volatility—fewer missed housing payments, less food insecurity, and less unmet essential expenses (Mills and Amick, 2010). And we know that there is a strong link between savings and economic mobility (Urahn et al., 2013). In short, this research tells us that escaping the perpetual financial insecurity of low-wage work requires more than incrementally higher wages; it also requires savings and investments for the future.

Unfortunately, the vast majority of those government benefits for building wealth go to the wealthiest households who need the least support, largely bypassing low-income AAPI households and other households of color. This upside-down system perpetuates the widespread wealth inequality we are seeing in this country, and it exacerbates the racial wealth gap that is holding back so many AAPIs and other households of color. By focusing our attention on strategies to update the tax code to better distribute its benefits, we will be able to support growing economic opportunity for AAPIs and other communities of color at all ends of the income and wealth spectrum.

To explore these upside-down policies, this paper will (1) illustrate how the tax code plays a role in widening the racial wealth gap for AAPIs and other communities of color, (2) explain how current asset-building tax programs are missing an opportunity to boost the wealth of AAPI and all American households, and (3) propose legislative action to create a more equitable and progressive tax code for all.

Growing Racial Wealth Gap

We cannot begin to solve widespread wealth inequality without intentionally addressing the racial wealth gap. According to the U.S. Census Bureau, by 2043, the minority population in the United States will surpass the white population (U.S. Census, 2012). AAPIs are one of the fastest-growing ethnic groups in the country and one that warrants increased attention. This demographic reality, coupled with the alarming trend of lost minority wealth, especially compared to white wealth, makes public policies to address the racial wealth gap vital.

In 2015, the Corporation for Enterprise Development's (CFED) *Assets and Opportunity Scorecard* found that households of color are disproportionately likely to live in "liquid asset poverty," meaning they do not have sufficient assets to subsist at the poverty level for three months if they lost their primary source of income. According to the *Scorecard*, two out of every three (61 percent) households of color are liquid asset poor, nearly the double the rate of white households (Brooks et al., 2015). Many of these households are essentially one paycheck away from falling into serious financial distress.

AAPI households are not immune to this financial insecurity. In fact, since the wake of the recession, the number of AAPIs living in poverty increased by more than half a million, representing an increase of 38 percent (37 percent increase in Asian Americans in poverty; 60 percent increase in Native Hawaiians and other Pacific Islanders in poverty) (Ishimatsu, 2013).

Further compounding these disparities is a growing racial wealth gap. According to research by the Urban Institute, the racial wealth gap has doubled in the past few decades (McKernan et al., 2013). In 1983, the average wealth of white families was $230,000 higher than the average wealth of African American and Hispanic families. By 2010, the average wealth of white families was more than half a million dollars higher than the average wealth of black and Hispanic families. Although the racial wealth gap is growing once again (Kochhar and Fry, 2014), a recent study by the Federal Reserve Bank of St. Louis found that the wealth gap is narrowing between Asian Americans and whites compared to between whites and other communities of color (Boshara, Emmons, and Noeth, 2015).

However, for the growing number of AAPIs earning lower wages or living in poverty, this data misses the nuances that exist within the AAPI community. As Ong and Patraporn have argued in their research, Asian Americans in the lowest wealth quartile continue to lag significantly behind whites. Wealth inequality persists among specific Asian American subgroups—a fact that is obscured by national aggregated data on Asian Americans (Ong and Patraporn, 2006; Ong, Patraporn, and Pech, 2009). The Great Recession has significantly exacerbated the wealth gap between white households and households of color. The Pew Research Center found that between 2005 and 2009, Asian Americans saw their wealth cut by 54 percent (Kochhar et al., 2011). In a subsequent study, the Urban Institute also found that between 2007 and 2010, Hispanic families saw their wealth cut by more than 40 percent, while African American families saw their wealth fall by 31 percent—three to four times the decline seen by white families during this same period (McKernan et al., 2013). The staggering statistics of all communities of color raise alarming concerns for AAPIs that often share a similar fate.

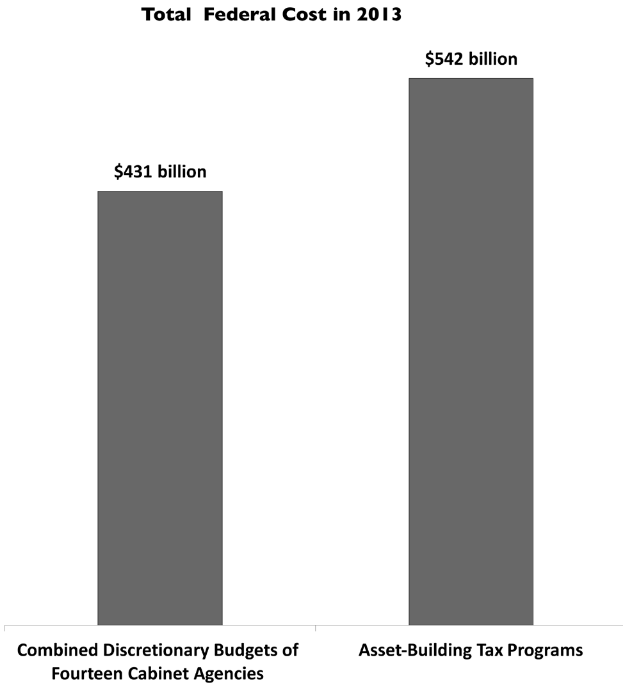
These statistics paint a gloomy picture that is only getting worse. This national problem demands a national solution that can reverse these troubling trends and close the racial wealth gap for good.

The U.S. Tax Code Is the Federal Government's Largest Asset-Building Program

Over the past twenty years, the federal government has spent more than $8 trillion through the tax code to help households save, invest, and build wealth (Levin, Greer, and Rademacher, 2014). However, an overwhelming majority of this tax spending has gone to the wealthiest Americans. Unfortunately, because the IRS does not collect information on the race or ethnicity of the tax filer, it is difficult to extrapolate how the tax code benefits different ethnic and racial categories. At the same time, we are able to determine how AAPI households are accessing various programs that serve to encourage savings and build wealth and can infer how AAPI and other communities of color are accessing the benefits of the tax code.

In 2013, the federal government spent $540 billion on asset-building tax programs focused on home ownership, savings, retirement, and higher education. To put this number in perspective, the amount spent was larger than the discretionary budgets of fourteen cabinet-level federal agencies—more than all but the Department of Defense (Figure 1). These programs, often called "tax expenditures," take the form of tax credits, deductions, exclusions, exemptions, deferrals, and reduced tax rates. But quite simply, a federal tax program is a federal spending program.

Figure 1. Federal Spending on Asset-Building Tax Programs Outweighs the Discretionary Budgets of Fourteen Cabinet Agencies



Note: The fourteen federal agencies consist of the Health & Human Services, Education, Veterans Affairs, State, Homeland Security, Justice, Energy, Agriculture, Housing & Urban Development, Transportation, Treasury, Labor, Interior, and Commerce.

The fact that tax programs are effectively spending programs should shift our thinking significantly around how to deliver social policy and economic opportunity to effectively support AAPI families. The Earned Income Tax Credit (EITC)—one of the largest "antipoverty" programs in the country—is often seen as an anomalous tax program in the economic opportunity policy space. However, the reality is that the EITC is just one of several social policy programs run through the tax code. In fact, when it comes to helping Americans build wealth, federal spending is mostly run through tax programs rather than through traditional spending programs. These tax programs target several different types of assets:

- **Home Ownership ($211 billion).** Home ownership has been one of the primary strategies that AAPIs have leveraged to build wealth. Home equity represents 70 percent of the total wealth of low- and moderate-income households (Grinstein-Weiss and Key, 2013). Even in the wake of the Great Recession, millions of Americans continue to view home ownership as a viable route toward developing a long-term source of wealth (Grinstein-Weiss et al., 2013). For example, in California, home ownership rates for AAPIs have been similar to the total population. Median home prices for AAPIs in California were higher ($556,000) than the total population ($461,000) driving rapid wealth accumulation. At the same time, more than half of these home owners suffered from significantly higher housing burden (53 percent) reflecting the tenuous nature of the wealth accumulation through housing (Peng et al., 2013). Tax programs like the Mortgage Interest Deduction and Deduction for State and Local Property Taxes primarily give support to households to take on more mortage debt and buy bigger homes.

- **Savings ($171 billion).** Nearly all families experience income fluctuations, and low- and moderate-income families are more likely to experience significant income interruptions. Reachable "liquid" savings help families weather these economic storms. A family can build this type of savings in two ways: save and invest their own income in accessible accounts, or receive the savings and investments of someone else as a gift or inheritance. Federal tax programs like special tax rates on capital gains and dividends actively boost these investments and inheritances. Unfortunately, for many AAPIs that face language barriers and other barriers related to immigration status, many are unable to successfully access bank accounts and other financial products that facilitate savings (Condon, Duong, and Pisnanont, 2015). And few, if any have access to investments and inheritances to take advantage of the benefits within the tax code.
- **Retirement Accounts ($128 billion).** Just half of working-age Americans are confident that they will have enough money to retire (Helman et al., 2013). According to the AARP Foundation, only 22 percent of Asian Americans between ages fifty and sixty-four have earned retirement income, compared to 37 percent of the general population (AARP Foundation, 2014). Even among households with savings, the median balance is only $40,000, still far less than many workers will need to maintain their standard of living in retirement (Rhee, 2013b). The federal government primarily supports retirement savings through tax-preferred retirement plans, like defined benefit plans, 401(k) plans, and IRAs.

- **Higher Education ($32 billion).** Higher education remains a vital resource for many AAPIs and is one the surest pathways out of poverty (Haskins, Holzer, and Lerman, 2009). There are two ways the federal tax programs support higher education: through after-purchase tax subsidies (like the deduction for higher education expenses), and through support for college savings (namely 529 and Coverdell education accounts). However, similar to other wealth-generating opportunities, these higher education opportunities are often concentrated among a few Asian subgroups, many of whom have benefited from preferential immigration policies, while eluding other AAPI subethnic groups such as Southeast Asians or Pacific Islanders (Chaudhari, Chan, and Ha, 2013).

Spending on these tax programs is projected to grow rapidly in the next few years. Figure 2 shows that by 2019 spending is scheduled to be 40 percent greater than it was in 2013 (controlling for inflation). From 2014 to 2019—the projections available in the most recent estimates by the Office of Management and Budget—these programs are estimated to cost the federal government a total of more than $4 trillion, a mind-boggling sum.

The Federal Tax Code Is Upside Down

So, what does "upside down" mean? It means the less income you have, the less these tax programs help you build wealth. It means the $540 billion in federal spending on these programs is, with a few exceptions, largely serving to expand the wealth of the already wealthy. It means that AAPI families who need the most help get helped the least.

The truth is that most individuals and families—those in the bottom 60 percent—receive less than 12 percent of the benefits from these programs. Households in the top 20 percent receive about seventy times as much support from these programs as do households in the bottom 20 percent. These benefits are incredibly focused on the highest-income households. The top 1 percent receives more than a quarter of all support from these programs—more than the entire bottom 80 percent combined (Figure 3).

How does this translate into actual, real-world dollar benefits for working families and in particular for households of color? To shed light on this question, Ben Harris and others at the Urban Institute and Brookings Institution's Tax Policy Center (TPC) conducted a distributional analysis of tax benefits (Harris and Weman, 2014) at the county and ZIP

Figure 2. From 2014 to 2019, the Federal Government Will Spend More Than $4 Trillion on Tax Programs to Boost Savings, Investments, and Wealth

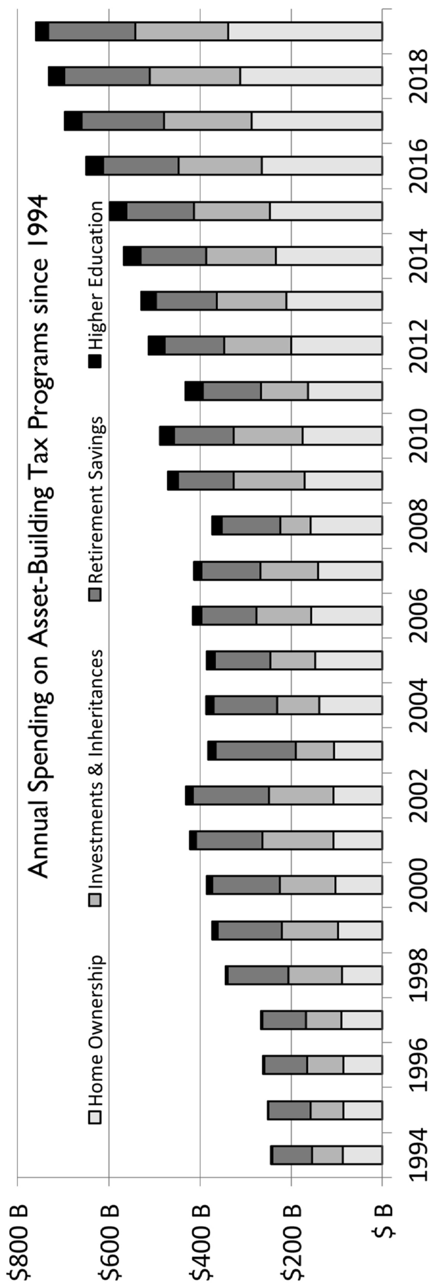
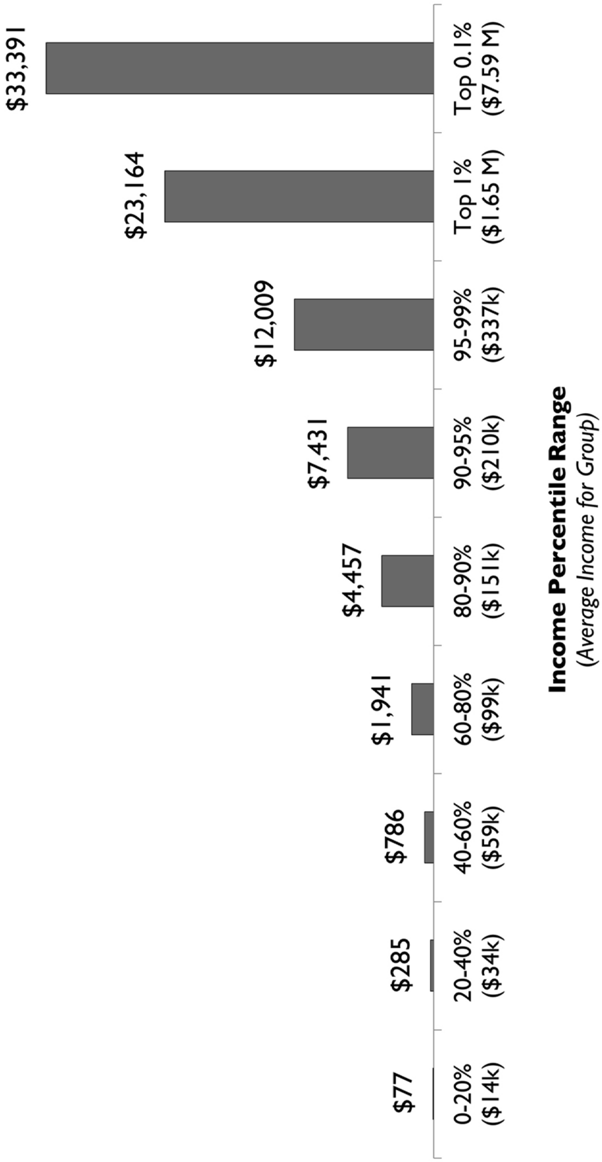


Figure 3. A Top-Income Family Could Buy a Cadillac with Their Annual Benefits. A Bottom-Income Family Could Barely Fill the Gas Tank.

Average Federal Benefit in 2013



code level. Using this data, TPC was able to compare the use of certain tax benefits in communities with high concentrations of households of color to predominantly white communities. Unsurprisingly, this research found that those who benefitted from the Mortgage Interest Deduction and preferred rate for capital gains were largely concentrated in white communities. For example, in 2012, three-quarters of those benefiting from capital gains resided in 10 percent of all ZIP codes, and these ZIP codes tended to be predominately white. However, in counties that were largely made up of households of color, there was a high utilization of the EITC, a tax program targeted to serve working families.

Most but not all tax programs are upside down. There are a few small but significant examples of right-side up policy among these programs:

- The Saver's Credit, which helps low- and moderate-income families build retirement savings, focuses the entirety of its support on the bottom 60 percent.
- The short-lived First Time Homebuyer Tax Credit also focused its support on low- and moderate-income households.
- The EITC often functions as a "forced savings" mechanism for low- and moderate-income workers.

These right-side up tax programs demonstrate that the problem with upside-down tax programs is not that they are tax programs—it is that they are upside down. It is perfectly possible to structure a tax program to help most working families build wealth. The next section explains the five reasons why tax programs so often fail to do this.

The Five Flaws That Make Tax Programs Upside Down

Flawed tax programs produce inequitable benefits. In general, these tax programs suffer one or more of five flaws that limit their usefulness for AAPI individuals and families who need the most help saving, investing, and building wealth.

1. **Itemized deductions exclude most households from benefits.** Two of the largest asset-building tax programs, the Mortgage Interest and Real Estate (Property) Tax Deductions, are available only to taxpayers who itemize deductions. Together, these programs cost $98 billion in 2013, accounting for one out of every six dollars spent on asset-building tax programs. The problem with these programs is that low- and moderate-income AAPI households are far less likely to itemize than high-income households. More than 95 percent of tax filers with

income more than $200,000 (approximately 8 percent of the AAPI households) itemized their deductions instead of claiming the standard deduction in 2011. By comparison, only 13 percent of tax filers with annual income of $50,000 or less (approximately 37 percent of the AAPI households) itemized their deductions.[1] A better way of delivering take-home benefits to working families is through tax credits. Taxpayers who use the standard deduction are still able to utilize credits. Further, refundable tax credits, such as the EITC, allow families to benefit whether they are required to pay taxes or not, thus making them incredibly effective antipoverty programs.

2. **Most tax programs increase support as a household's tax rate increases.** Deductions, exclusions, and deferrals account for the majority of federal wealth-building tax programs. The problem with these programs, as illustrated in figure 4, is that their support is directly tied to a household's tax rate. As a household's tax rate decreases, the support provided by these programs decreases as well. Again, tax credits are a far better way to deliver benefits to working families.

Figure 4. Moderate-Income Workers Get Less Than Half the Support as High-Income Workers Who Claim the Same Deductions

	Moderate-Income Family	High-Income Family
Income Tax Bracket	15%	39.60%
Mortgage Interest	$10,000	
Real Estate Tax	$3,500	
Retirement Savings	$2,000	
Student Loan Interest	$1,000	
Total Deductions	$16,500	
Value of Deductions	$2,475	$6,534

3. **The larger the asset, the more the support.** For example, real estate tax deductions are tied to the value of the home. The more expensive the home, the higher the taxes, and so the greater the real estate tax deduction (Figure 5). In 2013, households making less than $200,000 (approximately 92 percent of AAPI households) deducted an average of about $3,500 in real estate taxes. By comparison, the highest-income taxpayers (with income more than $10 million) deducted an average of more than $77,000.[2]

Figure 5. Tax Programs Subsidize Enormous Assets for High-Income Households

	High-Income, Modest Spender	High-Income, Big Spender
Income Tax Bracket	39.6%	
Mortgage Interest	$10,000	$40,000
Real Estate Tax	$3,500	$15,000
Retirement Savings	$2,000	$50,000
Student Loan Interest	$1,000	$5,000
Total Deductions	$16,500	$110,000
Value of Deductions	$6,534	$43,560

4. **Timing and structure of benefits prevents many families from benefiting.** Many tax programs time support in a way that cuts off access to low- and moderate-income households. For example, the American Opportunity Tax Credit provides support to students only after they have already paid for higher education expenses. Similarly, home ownership tax programs spread out support over years or decades of home ownership, for instance, through a subsidy for mortgage interest or real estate taxes. High-income households with adequate savings can invest today and receive support next year or years later. Because many would-be students and home owners cannot afford to pay college enrollment costs or home closing costs today, they won't receive support from the tax program next year.

5. **Many lack access to tax-preferred financial products and services.** For example, many families simply do not have the type of tax-preferred retirement accounts that give households access to retirement tax benefits, such as 401(k), 403(b), IRAs, and Keogh plans. Consider that in order for a worker to benefit from retirement tax programs, they must have access to retirement savings accounts, mostly available through the workplace. But roughly half of workers do not have access to an employer-sponsored retirement savings account. Only 22 percent of AAPI households have retirement income from pensions and various retirement plans (AARP Foundation, 2014). For employees with access to an employer-sponsored plan, saving for retirement can still be burdensome. Employment may be short term, and enrollment procedures are often complex. IRAs are an option for those without access to an employer-sponsored plan, but this option is not working well. Among Americans who have access solely to private IRAs, only a small percentage open and regularly contribute to these plans (Madrian and Shea, 2001).

Congress Must Act to Take the Tax Code from Upside Down to Right-Side Up

The flaws discussed in the preceding text are not required features of these tax programs—they are flaws that can be fixed. In order to realize the potential of these programs, the U.S. tax code must be reformed to turn the $540 billion in annual spending right-side up so that all Americans can save, invest, and build wealth. Due to the sheer size and scale of these programs, the adoption of even one or two of the following policies would have an incredible impact in moving from an upside-down to a right-side up tax code:

Home Ownership

- Replace the mortgage interest and real estate tax deductions with a simple, flat, refundable home ownership credit. A refundable credit would allow more taxpayers that do not itemize their tax returns or take the standard deduction to receive the benefits of the tax code.
- Establish a first-time home buyer's credit to help new home buyers afford closing costs of a first home. This credit would incentivize first-time home ownership, a key wealth-building activity for AAPI households, rather than only incentivizing households to buy larger homes or take on larger amounts of debt.
- Help families save for a first home down payment. Again, we should support programs and services through local community-based organizations that support AAPI households to reduce the barriers to achieving home ownership and accessing a critical wealth-building opportunity.
- Institute meaningful caps on home ownership tax support and use savings to structure the tax code to promote primary home ownership for all Americans.

Savings

- Establish a regenerating "Opportunity Fund" by reinstating historical tax rates on estates and inheritances. The fund would link two generations, with the wealth of one investing in the opportunity of the next.
- Support expanded eligibility for accessing the EITC to low- and moderate-income workers and those without dependents. This would greatly expand the number of workers that could access the EITC.

- Reform taxation of investment income, and use the federal revenue to support wealth-development programs for all workers.

Retirement Accounts

- Replace existing upside-down support for retirement savings with a flat refundable retirement savings credit.
- Reform the Saver's Credit, a credit aimed at encouraging retirement savings among lower-income households, into a refundable credit to make it accessible to more families earning lower wages.
- Establish universal, automatic enrollment retirement savings accounts for all workers to ensure greater access to retirement benefits for AAPI workers that don't have access to employer-sponsored retirement accounts.
- Apply meaningful caps to tax-supported retirement accounts and use the saved federal revenue to expand retirement savings support for all workers.

Higher Education

- Eliminate the higher education deduction and use the savings to create a college savings account for every child at birth. This would expand the benefits to more households, not only to those that are able individuals who are capable of achieving higher education.
- Reform the American Opportunity Tax Credit to support college savings directly as opposed to after the expenses are borne.
- Eliminate asset limits for recipients of public benefits who save using a Children's Savings Account. This would allow greater numbers of low-income households to access these benefits to apply their savings toward higher education.
- Expand the Saver's Credit, a credit currently aimed at encouraging retirement savings, to support college savings.

In order to achieve the vision of a right-side up tax code, working families, especially AAPIs and other households of color, must mobilize and demand that their representatives make the necessary policy changes to ensure that the tax code provides the same opportunities to build wealth for them as it does for higher income taxpayers. The reality is that members of Congress are not used to hearing from working families, let alone the AAPI community on these issues. They mostly hear from highly paid lobbyists and those in Washington who are content with the status quo. It is incumbent upon us who care about the financial well-being of these communities that we educate and mobilize them so that their voices are heard in the halls of Congress.

The time to do this is right now. As this paper goes to print, members of Congress are in the throes of a debate over how to reform the tax code. It may take several years—and a presidential election—to accomplish, but we are on the path to tax reform. Our federal tax code has not been overhauled since 1986, and there is bipartisan agreement that the time to reform the code is long overdue. However, there are fundamental disagreements on the specific policies that would comprise a bipartisan tax reform bill. The good news is that there is also bipartisan support for many of the policy reforms that would move us closer to turning the tax code right-side up. To get there, it will take a concerted advocacy effort and an active advocacy community to ensure that the upside-down tax programs in the areas of savings and investments, home ownership, retirement, and education work to enhance the wealth of communities of color.

Networks are already beginning to mobilize across the country to embark on this effort. One such network is the Asset Building Policy Network (ABPN). The ABPN—a coalition comprised of a financial institution and eight of the nation's leading civil rights and asset-building organizations—is working to engage the low- and moderate-income communities and households of color they serve in the tax reform conversation.[3] The ABPN is actively working to advance tax reform that is equitable, progressive, and universal in its capacity to support and enhance the assets and wealth of all American households, particularly for low-income APPIs as well as other communities of color.

Conclusion

One of the most striking economic trends in America over the last several decades has been the rise of income inequality. While income inequality has received a great deal of attention, it's dwarfed by the growth of wealth inequality (Rampell, 2011). The top 1 percent of Americans now own roughly 40 percent of the wealth in America, more than at any time since the 1930s (Piketty and Zucman, 2014). At the same time, nearly half of Americans and every two in three households of color, including AAPIs are "liquid asset poor," meaning they lack even the most basic levels of savings (Brooks et al., 2014). The Great Recession has only made this picture bleaker with the major loss of wealth by AAPI households (Bricker et al., 2014; Fry and Taylor 2013; Wolff 2012).

As we have noted in this paper, the federal government is not sitting on the sidelines. Recognizing the importance of assets both to the American Dream and the American economy, the federal government spent more than $540 billion in 2013 alone to promote savings, retirement accounts, higher education, and home ownership. Unfortunately, as we have noted many AAPIs lack access to the very wealth-generating opportunities supported by the tax code. Instead, this federal largesse primarily helps the wealthiest Americans build more wealth. In short, these tax programs are upside down and, more often than not, are failing to expand financial security or economic opportunity for many AAPIs and our most vulnerable communities. By turning these tax programs right-side up, we can begin to close the racial wealth gap and make an historic investment in economic opportunity for not just AAPI families, but for all communities.

Notes

1. Author's calculations based on 2012 IRS Statistics of Income, 2014 data release.
2. *Ibid*.
3. The ABPN is comprised of the Center for American Progress, Corporation for Enterprise Development, Citi, The Leadership Conference on Civil and Human Rights, National Coalition for Asian Pacific American Community Development (National CAPACD), National Association of Latino Community Asset Builders, National Council of La Raza, National Urban League, and PolicyLink.

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