

FROM **UPSIDE DOWN** TO **RIGHT-SIDE UP**

TURNING THE TAX CODE INTO AN ENGINE FOR
ECONOMIC AND RACIAL EQUALITY

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About Prosperity Now

Prosperity Now (formerly CFED) believes that everyone deserves a chance to prosper. Since 1979, we have helped make it possible for millions of people, especially people of color and those of limited incomes, to achieve financial security, stability and, ultimately, prosperity. We offer a unique combination of scalable practical solutions, in-depth research and proven policy solutions, all aimed at building wealth for those who need it most.

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Executive Summary

Who are government services and programs intended to serve? Corporations or citizens? The wealthy among us or the most vulnerable and disenfranchised? White communities or communities of color? During the first six months of 2020—as the nation grappled with the COVID-19 pandemic and the senseless murders of Ahmaud Arbery, Breonna Taylor, George Floyd and Rayshard Brooks—national attention has once again turned to these pressing questions and countless others.

But while these events have once again exposed the financial fragility of so many, the vulnerabilities of our government systems at all levels—from health care, housing, the economy and more—and the effect of systemic racism against communities of color, the reality is that many of the issues that have unfolded are no accident. Instead, they are the compounding byproduct of public policies made over generations that tilt the social and economic scales in favor of the wealthy over everyone else, and particularly in favor of White communities over communities of color at nearly every turn.

While many of these choices and policies have been and continue to be clearly visible, many more are not.

For instance, the government’s main means for raising revenue to pay for programs and services—the federal income tax system—may seem like one that should serve all without prejudice, but it, too, is riddled with systemic racism and inequality. In fact, when it comes to race, while the income tax system and many state tax systems do not explicitly take race into account, their history and design are embedded with racial bias and are built on an economic system infused with systemic racism. And, when it comes to income, while the overall tax code is moderately progressive, meaning that it modestly works to close income and wealth gaps, many of its key features are accessed almost exclusively by the wealthy. Even when they are not, the vast majority of the benefits of these provisions still accrue to them.

Although reform of our tax code may not seem to be the most pressing issue at this moment, it is essential for two reasons. First, wealth plays a significant role in perpetuating systemic racism and economic inequality. Second, the federal government spends about \$634 billion a year through the tax code promoting savings, retirement accounts, higher education, and homeownership—dollars which largely go to help wealthy, mostly White, households build wealth.

We know that the government can design tax programs—and by extension a tax system—that meaningfully and immediately can respond to the issues before us and support those who need the most help. For example, the stimulus rebates program, part of the \$1.7 trillion dollar Coronavirus Aid, Relief and Economic Security (CARES) Act, the Earned Income Tax Credit (EITC) and the Child Tax Credits (CTC). We consider these programs to be right-side up—meaning the more an individual or family needs support, the more support they get. The federal government can and needs to do more of them.

With more of the public now recognizing systemic racism as a serious issue that needs to be addressed, and with the individual tax provisions within the nearly \$2 trillion Tax Cuts and Jobs Act set to expire at the end of 2025, Congress will soon have a clear opportunity to make historic investments that can begin to close the gaps between those at the top and everyone else and between White communities and communities of color.

Tax Spending is Government Spending by Another Name

Data from the Office of Management and Budget shows that the amount spent on more than 20 federal wealth-building tax programs that promote savings, retirement accounts, higher education and homeownership was about \$634 billion in 2019. That's more than the *combined* discretionary budgets of 14 of the 15 cabinet-level agencies that same year—\$577 billion.

Most of this spending flows through programs that are *upside down*, meaning the more an individual or family needs support, the less support they get. As a result, a relatively small portion of this spending went to those who need the most wealth-building support. In fact, using most recently available data from Tax Policy Center, we conservatively estimate that in 2019, a millionaire received an average benefit of about \$160,000 from spending made through wealth-building tax programs. In contrast, a working family—earning less than \$50,000—received just about \$220, on average from this wealth-building tax spending.

These tax programs suffer from one or more of four flaws that limit their usefulness for individuals and families who need the most support:

- Itemized deductions exclude lower-income households from any benefits.
- Most tax programs increase support to a household as their tax rate increases.
- The larger the asset, the more the support.
- Timing and structure of many tax programs can prevent families from benefiting.

Most Tax Provisions are Upside Down But A Few Can Be Held Up as Examples of Right-Side Up Policies

Taken together, upside down provisions within the overall tax code serve to drive overall economic inequality, and also to widen long-standing inequities facing communities of color. The Mortgage Interest Deduction (MID) is a prime illustration. Newly produced estimates by the Institute on Taxation and Economic Policy (ITEP) show that the MID continues to disproportionately benefit White households:

- White households receive 78.4% of the MID's benefits, despite making up 68.8% of all tax returns.
- Asian, Black and Latino households receive 19.5% of the MID's benefits, despite making up 28.4% of all tax returns.
- The top 20% of White households—who make up 15.8% of all tax returns—receive 59.1% of the MID's benefits. In contrast, the top 20% of Black and Hispanic households, which make up 2.4% of all returns, receive 8.8% of the MID's benefits. Asian households in the top 20%, which make up 1.3% of all returns, receive 4.9% of the MID's benefits.

However, a few right-side up tax provisions can be held up as examples to show that it is possible to create tax policy that benefits low- and moderate-income households and households of color:

- Black, Native American and/or Alaska Native, Native Hawaiian/other Pacific Islander and Hispanic households make up 24.9% of all tax returns but account for 40.1% of all the tax returns claiming the EITC. (These taxpayers' collective income is about 16%—lower than their share of the overall population.)

- Black households make up 17.2% of those claiming the EITC; they receive 18.1% of all EITC benefits.
- Hispanic households make up 21.2% of those claiming the EITC; they receive 24.6% of all EITC benefits.

Our Opportunity to Turn the Tax Code Right-Side Up for Economic and Racial Justice is Now

COVID-19 and the recession have exposed and put pressure on the financial fragility of so many people at the bottom of the income distribution. As we recover from this crisis, and as we deal as a nation with systemic racism in the most overt form and in every place it exists, we cannot make progress by going back to “same as before”. Indeed, while many of the crises that have been elevated in the first six months of 2020 predate the moment that we are in, any semblance of recovery must be grounded in addressing the origins of those crises. Creating a more just and equitable society in which *all*—but especially Black and indigenous people, and other people of color—can prosper will require both new investments and a meaningful redirection of existing resources that primarily serve to calcify economic and racial inequality. The \$634 billion spent through upside-down tax programs represent a significant pool of resources that can serve as a down payment to begin remedying the persistent and insidious role of systemic racism in government programs and our tax code. We just need to start turning our upside-down tax spending right-side up.

The following policies are a few examples of how Congress should act:

- Expand and strengthen tax credits for working families, such as the EITC, to support low- and moderate-income families, bolstering their income and ability to save.
- Help low- and moderate-income families with housing costs, and build pathways towards successful homeownership.
- Create a universal, simple, safe and affordable retirement savings account for all households, along with incentives to save.
- Provide every child with a meaningful birthright investment to narrow the massive racial wealth divide.

From Upside Down to Right-Side Up:

Turning the Tax Code Into an Engine for Economic and Racial Equality

Emanuel Nieves, Joanna Ain and David Newville

Introduction

Who Are Government Programs Intended to Serve?

Is it corporations or is it the citizens? Is it the wealthy among us or is it the most vulnerable and disenfranchised? Is it White communities or communities of color? During the first six months of 2020—as the nation grappled with the COVID-19 global pandemic and the senseless murders of Ahmaud Arbery, Breonna Taylor, George Floyd and Rayshard Brooks—national attention has once again turned to these and countless other pressing questions.

These events have once again exposed the financial vulnerability of so many, the inadequacies in our government systems at all levels—from health care, housing, the economy and more—and the pervasive and insidious infiltration of systemic racism against communities of color. But as shocking and eye-opening as these events may have been to some, the reality is that many of the issues that have unfolded over these months are no accident. Instead, they are the natural and compounding byproduct of public choices and policies made over generations that have served to tilt the social and economic scales in favor of the wealthy over everyone else and in favor of White communities over communities of color at nearly every turn.

While many of these choices and policies have been and continue to be clearly visible, others are not. For instance, though the federal government's main means for raising revenue to pay for programs and services—the federal income tax system—may seem like one that serves all without prejudice, it is grounded in systemic racism and inequality. In fact, while the federal income tax system (and many state tax systems) do not explicitly take race into account, their history and design are embedded with racial bias and built on an economic system infused with systemic racism.¹ These issues can be seen in the 2017 tax law, the Tax Cuts and Jobs Act, which has been found to benefit White households significantly more than households of color.² And when it comes to income, while the overall tax code is moderately progressive, many of its key features are not. As we detail in this report, large chunks of these features are accessed almost exclusively by the wealthy, and even when they are not, the vast majority of the benefits of these provisions still go to them, providing the most benefits to those who need them the least and the least to those who need them the most.

As many throughout the nation work to address injustices faced by people of color—especially when dealing with law enforcement—and as we grapple with the effects of COVID-19, we need to do more than make incremental reforms. We cannot return to the “same as before” if we are to meaningfully address the numerous issues that have been brought to the forefront once again in the first six months of 2020.

How Upside-Down Tax Policies Perpetuate Systemic Racism and Economic Inequality.

Although reform of our tax code may not be the most pressing issue at this moment, it is essential for two reasons. First, because of the role wealth plays in perpetuating systemic racism and economic inequality in our society. And second, because each year the federal government spends hundreds of billions through the tax code to promote savings, homeownership, retirement and higher education, which largely go to help wealthy, mostly White, households build wealth.

Why does the government spend so much on these four assets? Each is linked to financial security and economic opportunity. Savings help families weather financial shocks and move up the economic ladder.³ Children with savings are more likely to attend and graduate from college and excel later in life.⁴ Personal retirement savings are increasingly necessary to guarantee a secure retirement,⁵ while homeownership remains a large source of personal wealth.⁶ Unfortunately, most of the federal government's spending through the tax code to boost opportunity through these assets comes through flawed, upside-down tax programs, which fuel economic and racial inequality.

These programs are flawed—not because they are tax programs, but because they do little for most working families. We call these programs “upside down,” because the more an individual or family needs support, the less support they get. At a time of record economic inequality—with the top one percent of wealthy Americans now owning the same share of the nation's wealth as the bottom 90% *combined* (31.2%), and communities of color owning 15.1% of the nation's wealth⁷—upside-down tax programs are further concentrating wealth⁸ in the hands of a few at an enormous cost to both the federal government and our society.

The Path Forward for Enacting a Right-Side up Tax Code.

We know that the government can design tax programs—and by extension a tax system—that meaningfully and immediately can both respond to the issues before us and support those that need the most help. For instance, the stimulus tax rebates (Economic Impact Payments) part of the \$1.7 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, represents a good, though limited, example of how the federal tax system can be used to help the most vulnerable. The Earned Income Tax Credit (EITC) and the Child Tax Credits (CTC)—two of the nation's largest and most effective anti-poverty programs—are also good examples. We consider these programs to be right-side up, and the federal government can and should create more.

The needless and tragic deaths of Mr. Arbery, Ms. Taylor, Mr. Floyd, Mr. Brooks and countless other unarmed Black Americans brought renewed energy for immediate and substantial changes to policing and the criminal justice system at large and to an array of social justice issues. But as this necessary work continues, we must also focus on the systemic and foundational issues of inequality that exist throughout all our government programs. And so, with more of the public now recognizing systemic racism, and with the individual tax provisions within the nearly \$2 trillion Tax Cuts and Jobs Act set to expire at the end of 2025, Congress will soon have a clear opportunity to make historic investments that can begin to close, rather than further widen, the gaps between those at the top and everyone else and those between White communities and communities of color.

Building on two previous reports—*From Upside Down to Right-Side Up: Redeploying \$540 Billion in Federal Spending to Help All Families Save, Invest and Build Wealth* and *Upside Down and Upside Down: The \$400 Billion Federal Asset-Building Budget*—this newest version of our *Upside Down* report examines new and old data through an income and racial wealth equity lens to analyze the size of federal tax programs. We enumerate *who* receives support from these programs; *why* these tax programs are upside down; and *how* federal reforms can turn the programs right-side up.

In doing so, we aim not only to document the rising cost of upside-down tax programs, but also show how we can create a right-side up tax code that helps *all* households save, invest and build wealth.

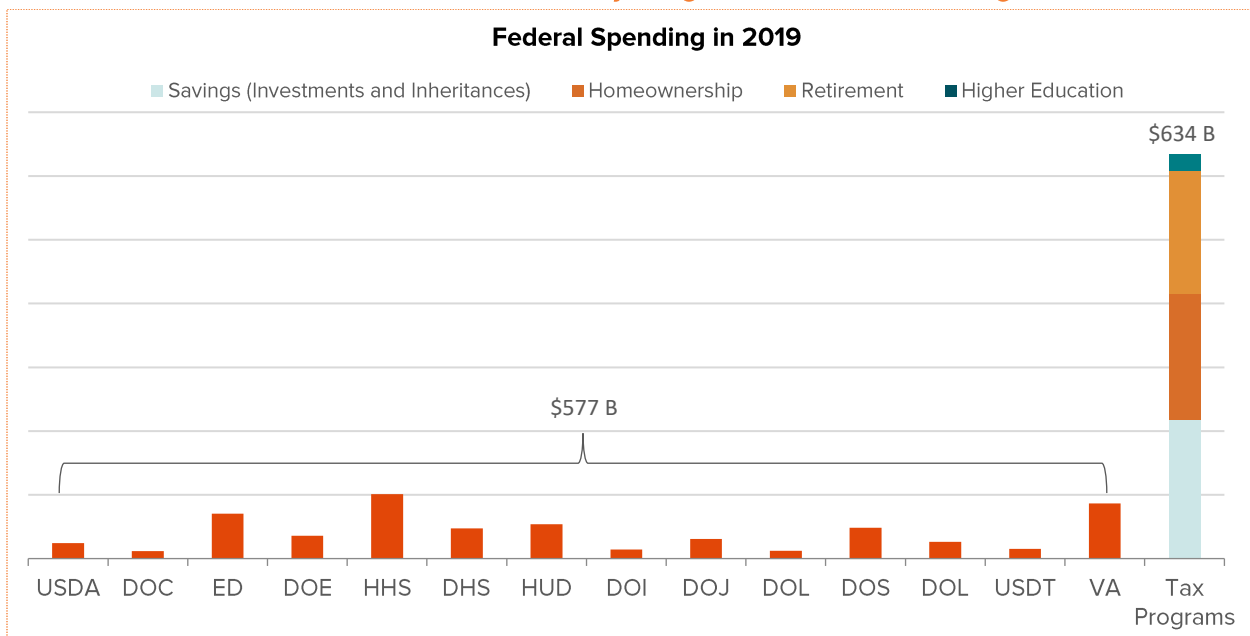
1 The \$634 Billion Tax Budget to Help Households Save, Invest and Build Wealth

Policy debates about government spending tend to focus almost exclusively on traditional spending programs. However, while these debates are not new to our national dialogue, they are often different when spending is done through tax programs—often called “tax expenditures”⁹—rather than through traditional programs. But this is a difference without distinction. Policy experts of all political persuasions agree that tax expenditures—tax breaks for specific types of activity or filers that take the form of tax credits, deductions, exclusions, exemptions, deferrals and reduced tax rates—are just government spending by another name.

The fact that tax programs are effectively spending programs should significantly inform debates around social policy and economic opportunity. For example, while EITC is often seen as an anomalous tax program in the economic opportunity policy space, the reality is that this is just one of several social policy programs run through the tax code.

Overall, the combined amount spent through more than 20 federal wealth-building tax programs focused on promoting savings, retirement accounts, higher education and homeownership roughly cost the federal government \$634 billion in 2019.¹⁰ This is an enormous sum compared to almost any other sort of federal spending on non-defense programs. To put this into perspective, that sum was larger than the *combined* discretionary budgets of 14 of the 15 cabinet-level agencies that same year.¹¹

Federal Wealth-Building Tax Spending in 2019 Was Larger Than the Combined Discretionary Budgets of 14 Cabinet-Level Agencies



Source: Author’s calculations based on budget and tax expenditure data from the Office of Management and Budget (FY 2021). Wealth-building tax programs include tax expenditures for homeownership, investments and inheritances, retirement and higher education.

The roughly \$634 billion spent in 2019 through wealth-building tax programs was distributed across the following four areas:

- **\$217 Billion – Savings.** Savings help families weather economic storms and also provide them with the flexibility to plan for and invest in their future through wealth-building assets, like higher education or homeownership. Typically, families can build savings in two ways: save and invest their own income in accounts or receive the savings and investments of someone else as a gift or inheritance. Spending through federal savings tax programs focuses on boosting savings through investments and inheritances.¹²
- **\$198 Billion – Homeownership.** While home equity represents a large portion of the total wealth for most households, it is a critical element of the wealth owned by low- and moderate-income households, especially households of color. But rather than supporting low- and moderate-income families, federal homeownership tax programs primarily give support to wealthier households to take on more mortgage debt and buy bigger homes.
- **\$193 Billion – Retirement.** More than one in every three workers say they are not confident they will have enough money to retire,¹³ and nearly half of all families have no retirement savings at all.¹⁴ Even among households with savings, the median working family has less than \$8,000 set aside in a retirement account—nowhere near the amount workers will need to maintain their standard of living in retirement.¹⁵ Federal retirement tax programs primarily support retirement savings through tax-preferred retirement plans, like defined benefit (DB) plans, 401(k) plans and Individual Retirement Accounts (IRAs).
- **\$25 Billion – Higher Education.** Higher education is one of the surest pathways out of poverty.¹⁶ There are two ways that federal tax programs support higher education: through after-purchase tax subsidies (e.g. deduction for higher education expenses) and through support for college savings (e.g. 529 and Coverdell education accounts).

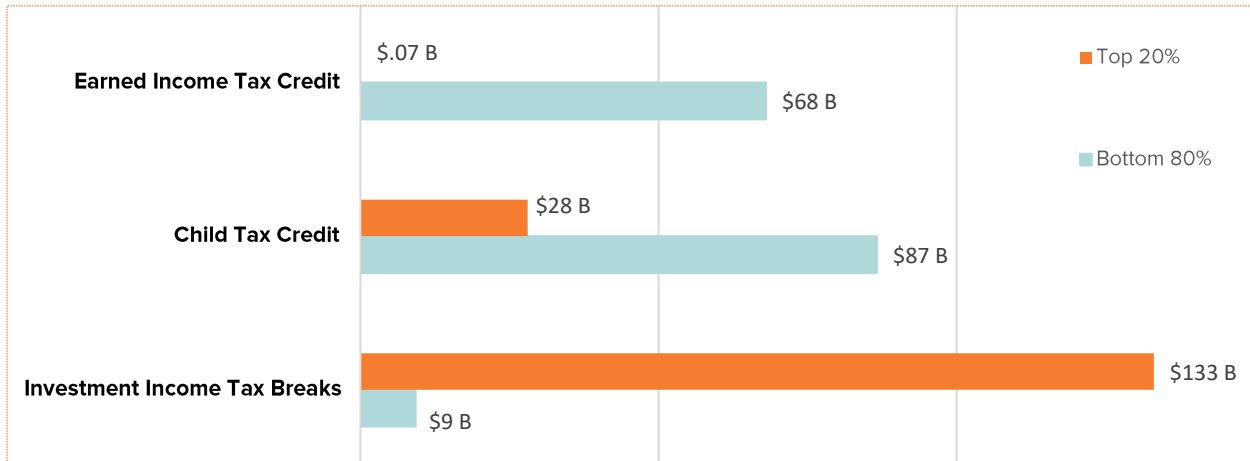
NOTE: See Appendix for summary of all cited tax expenditures.

As noteworthy as all this spending may be, little of it goes to support the economic well-being of those who need the most wealth-building support. In fact, using most recently available data from Tax Policy Center, we conservatively estimate that in 2019, millionaires received an average benefit of about \$160,000, while working families—earning less than \$50,000—received just about \$220, on average, from the spending made through the same wealth-building tax programs. And while this is an aggregate picture of the distribution of most of the \$634 billion spent through these areas, when you parse out the spending within each of these areas, it is clear that many of these programs are designed to focus more of their support on higher-income households, especially when compared to other tax programs.

For example, in 2019 the federal government spent about \$183 billion through the EITC and CTC to build financial security and boost opportunity for working families and their children—a noteworthy and meaningful investment considering that the support went to those who needed it the most. But that same year, the federal government also spent 77% as much (\$142.6 billion) through investment income tax breaks—also known as the “preferential tax treatment of capital gains and qualified dividends”—to provide the top 20% of

households lower tax rates on incomes that were unearned. In other words, while the EITC and CTC are at times labeled “expensive” or “welfare,” the reality is that the tax code spends just as much, if not more, on wealth-building programs for the rich.

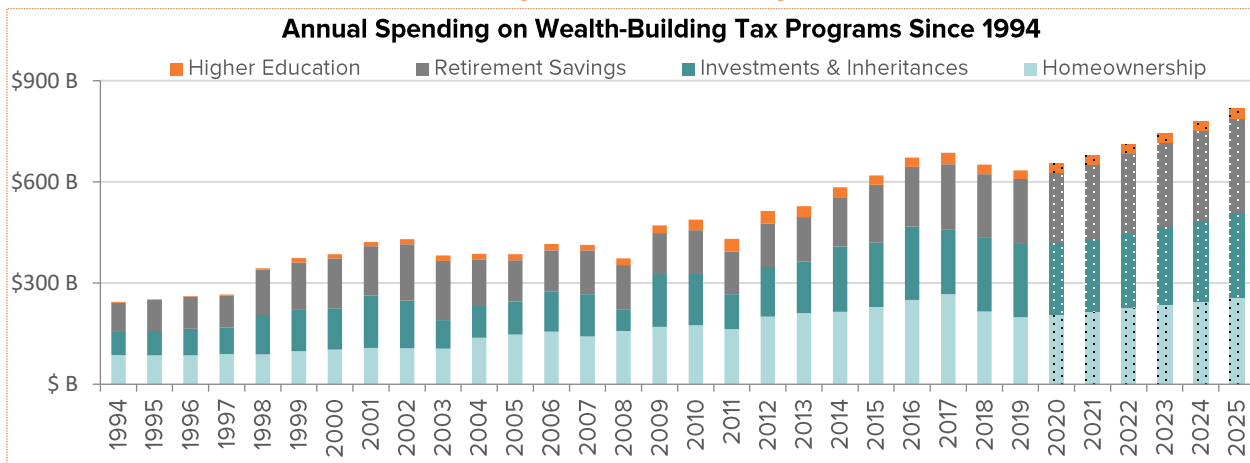
**Investment Income Tax Breaks Target High-Income Households
More Than Tax Credits Target Low-Income Workers**



Source: Author's calculations based on tax expenditure data from the Office of Management and Budget (FY 2021).

Spending on wealth-building tax programs is projected to grow rapidly in the next few years. The Office of Management and Budget (OMB) projects that in 2025 spending will be 28% greater than it was in 2019 (controlling for inflation). And between 2020 and 2025, these programs will cost the federal government more than **\$4.3 trillion**.

**Between 2020 and 2025, the Federal Government Will Spend
About \$4.3 Trillion on Tax Programs to Boost Savings, Investments and Wealth**



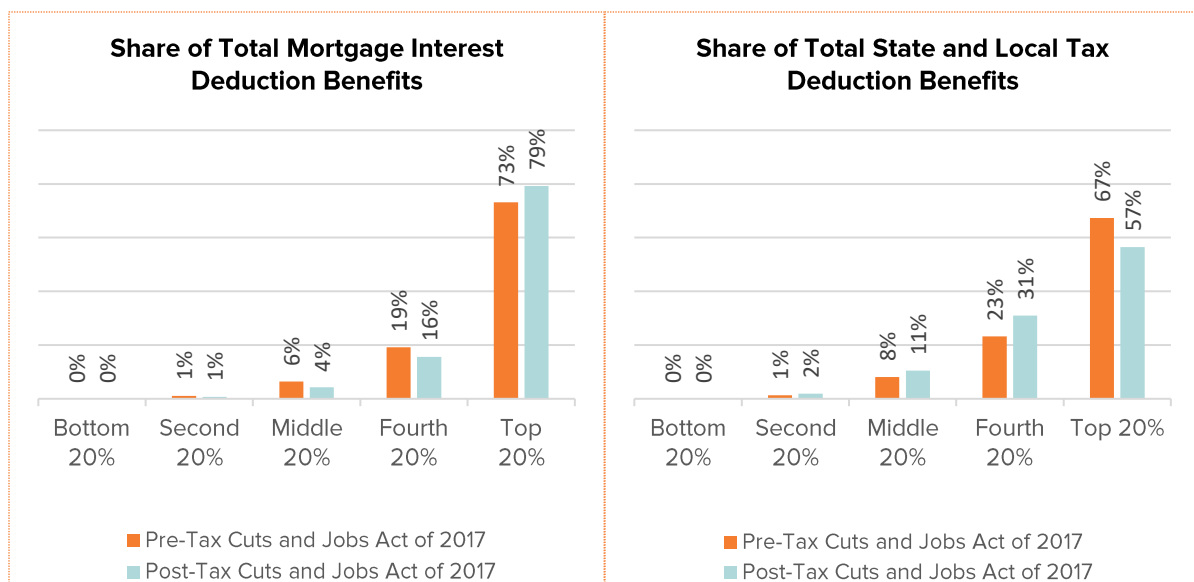
Source: Author's calculations based on tax expenditure data from the [National Priorities Project](#) and the Office of Management and Budget (FY 2021). Inflation-adjusted 2019 dollars.

2 The Four Flaws that Make Tax Programs Upside Down

What makes this tax spending so upside down? Each of the wealth-building tax programs the federal government spends about \$634 billion to support—savings, homeownership, retirement and higher education—suffers from at least one of four flaws that limit their usefulness for households who need the most support:

1. **Itemized deductions exclude lower-income households from any benefits.** Typically, if the sum of itemized deductions is less than the standard deduction, tax filers stick with the standard deduction. This limits the kinds of tax benefits a household can access. Historically, high-income households have been far more likely to itemize than low- and moderate-income households, and thus more likely to access high-value tax benefits. However, because of the 2017 tax law, the threshold for choosing to itemize has doubled. Today, that amounts to \$12,000 for single households and \$24,000 for married households, which makes it far less likely for low- and moderate-income families to have access to itemized tax benefits.¹⁷

Indeed, among households with adjusted gross incomes under \$50,000, estimates suggest that the 2017 tax law's changes to the standard deduction led to an 86% reduction in these households itemizing their deductions.¹⁸ By contrast, among those earning between \$100,00 and \$200,000, these changes led to about a 70% reduction in the number of these households that chose to itemize their deductions and a 47% reduction among those earning more than \$200,000.¹⁹ Overall, changes to the standard deduction have led to valuable tax benefits, like the Mortgage Interest Deduction (MID) and State and Local Tax (SALT) deduction, to be further concentrated among those at the top.



Source: Tax Policy Center, Model Estimates for Itemized Deduction for Home Mortgage Interest (T18-0169, T18-0171) and Itemized Deduction for Property Taxes (T18-0165, T18-0167).

2. **Most tax programs increase support to a household as their tax rate increases.** Deductions, exclusions and deferrals account for the majority of federal wealth-building tax programs. As the table below illustrates, the problem with these programs is that their support is directly tied to a household's tax rate—meaning that as a household's tax rate decreases, the support provided by these programs decreases as well.

Example Annual Tax Filing 2019	Moderate-Income Family <i>Incomes between \$19,401 to \$78,950</i>	High-Income Family <i>Incomes greater than \$612,351</i>
Income Tax Bracket	12%	37%
Mortgage Interest		\$10,000
State and Local Taxes		\$3,500
IRA Contributions		\$2,000
Student Loan Interest		\$1,000
Total Deductions		\$16,500
Tax Benefit	\$1,980	\$6,105

Source: Author's calculations.

3. **The larger the asset, the more the support.** SALT deductions, for example, are tied to the value of the home, which means that the more expensive the home, the higher the taxes and thus the greater the real estate tax deduction. In 2019, according to the Joint Committee on Taxation (JCT), households making less than \$100,000 received an average benefit of up to \$1,508 from the SALT deduction.²⁰ By comparison, households earning \$200,000 or more received, on average, more than seven times more support from the same deduction (\$11,708).²¹ This was due, in part, to having significant investment income and very large estates.

And while some tax programs limit support for assets above a certain size, even these programs subsidize extraordinarily large assets. For instance, at a time when the median total retirement savings is just \$60,000,²² federally supported retirement accounts can subsidize more than \$55,000 in savings every year.²³ Moreover, these already high caps are often circumvented through loopholes. For example, by combining a DB plan with a 401(k) plan, high-income workers can shelter about \$150,000 from taxes.²⁴ This costs a few thousand dollars in accountant fees²⁵ but produces tens of thousands of dollars in federal tax benefits.

More broadly, with the taxation of estates at historic lows, the many loopholes²⁶ that allow some to shelter millions of dollars from the tax and the decision by Congress to double the estate tax exemption level to \$11.2 million in 2017, our primary wealth-building tool—the tax code—now further subsidizes the wealth of wealthy families, allowing most estates to avoid taxes altogether.

Example Annual Tax Filing 2019	High-Income, Modest Spender	High-Income, Big Spender
Income Tax Bracket		37%
Mortgage Interest	\$10,000	\$40,000
State and Local Taxes	\$5,500	\$10,000
IRA Contributions	\$10,000	\$50,000
Student Loan Interest	\$2,000	\$2,500
Total Deductions	\$16,500	\$102,500
Tax Benefit	\$10,175	\$37,925

Source: Author's calculations.

4. **Timing and structure of many tax programs can prevent families from benefiting.** Many tax programs time support in a way that cuts off access for low- and moderate-income households. Today, more than 90% of higher education tax spending comes in the form of after-purchase subsidies, meaning households receive the tax benefit months after paying for tuition, buying books or financing some other qualified education expenses. In addition, homeownership tax programs spread out support over years or decades of homeownership, through a subsidy for mortgage interest or real estate taxes.

This timing of support naturally benefits high-income households who can tap into existing savings to invest in homeownership or higher education today while counting on support in the future, after they file taxes. For example, a 30-year mortgage on a \$300,000 home, with 20% down payment and 3.3% interest rate, will result in around \$138,000 in interest over the life of the loan. With a down payment of 3.5%, that same mortgage will result in around \$167,000 in interest over the life of the loan. For a middle-income family facing a 12% tax rate (with incomes between \$19,401 and \$78,950 in 2019), the MID would provide them with benefits between \$30,000 and \$36,000 over the life of their mortgage. But if a family cannot afford the down payment and closing costs to begin with, they will never purchase the home, let alone benefit from any homeownership tax program. While this may not be a problem for high-income families with a large amount of savings, poorly timed tax programs do little to support the immediate needs of low- and moderate-income families, many of whom lack the savings to cover an unexpected \$400 financial emergency²⁷ or to subsist for three months at the federal poverty line.²⁸

At the same time, the structure of support within these asset-building tax programs ends up also serving as a barrier to many households. For example, for a worker to benefit from retirement tax programs she must have access to a retirement savings account. But over one-third of workers do not have access to an employer-sponsored retirement savings plan,²⁹ and employees of color are less likely to have access than White employees.³⁰ Similarly, in order to take advantage of the tax benefits from saving and investing, a worker needs access to a savings or investment account. Today, unfortunately, about one in every three households is unbanked, meaning they lack even a simple checking account, let alone an investment account, or are underbanked, meaning they have a bank account but also rely on alternative financial services—such as check cashers and payday lenders—to carry out everyday financial

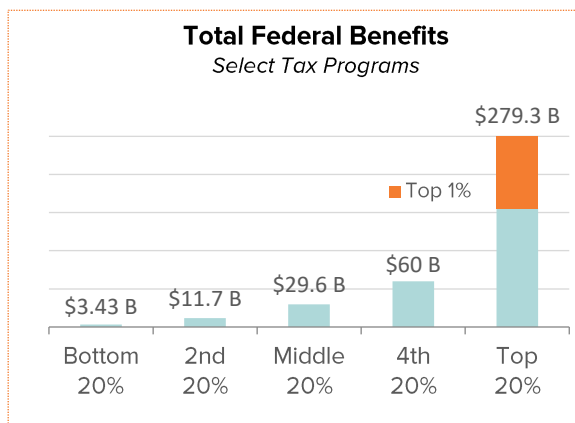
In the end, when benefits are dependent on front-loading what can be thousands of dollars and use of certain accounts, it is not hard to imagine why these programs do little to help low- and moderate-income families build assets and wealth.

3 The Upside Down Nature of Tax Programs Means Most Families Barely Benefit

“Upside down” means the less income a working family has, the less these tax programs will help them build wealth. It means the \$634 billion in federal spending on these programs is, with a few exceptions, expanding the wealth of the wealthy. And that low- and moderate-income families, who need the most support, receive the least.

Analyzing data from the Tax Policy Center that accounts for about \$385 billion spent in 2019 on federal tax programs to support savings, homeownership, retirement and higher education,³⁴ we conservatively estimate that households in the bottom 60% received just 12% of the benefits from these programs. In contrast, households in the top 20% received 73% of the support provided through these programs that year.

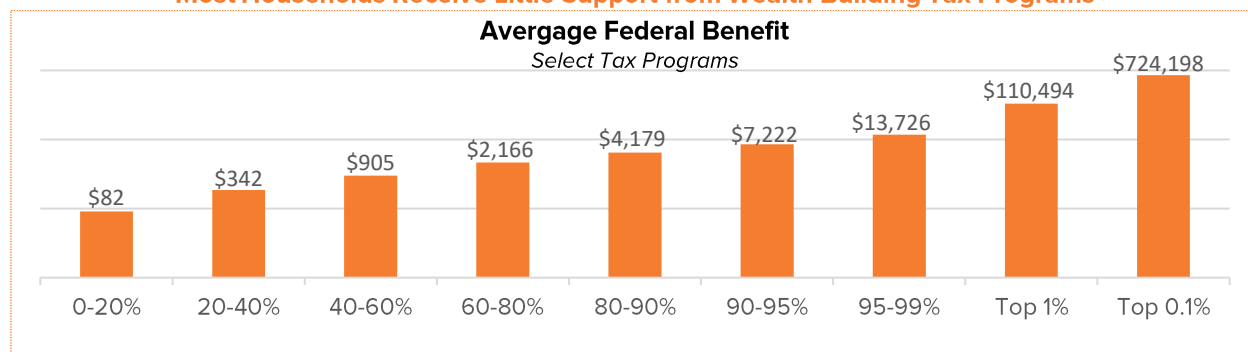
Most Households Receive Little from Wealth-Building Tax Programs



Source: Author's estimates based on tax expenditure data from the Tax Policy Center (2017-2019) and the Office of Management and Budget (FY 2021).

In terms of total dollars, we estimate that the top one percent received \$123.9 billion in support from these programs in 2019—more than what the bottom 80% received combined (\$104.6 billion). And on average, the top one percent of households received nearly four times as much support (\$110,494) from these programs to build their wealth in 2019 than the bottom 99% received *combined* (\$28,621).³⁵

Most Households Receive Little Support from Wealth-Building Tax Programs



Source: Author's estimates are based tax expenditure data from the Tax Policy Center (2017-2018). Average benefits are inflation-adjusted to 2019 dollars.

Unfortunately, these disparities are not a bug of our tax code. Instead, they are a defining feature of our tax code. As we document throughout the remainder of this report, at nearly every turn, wealth-building tax programs and our tax code more broadly heavily favor and reward high-income, wealthy, mostly White households.

Savings

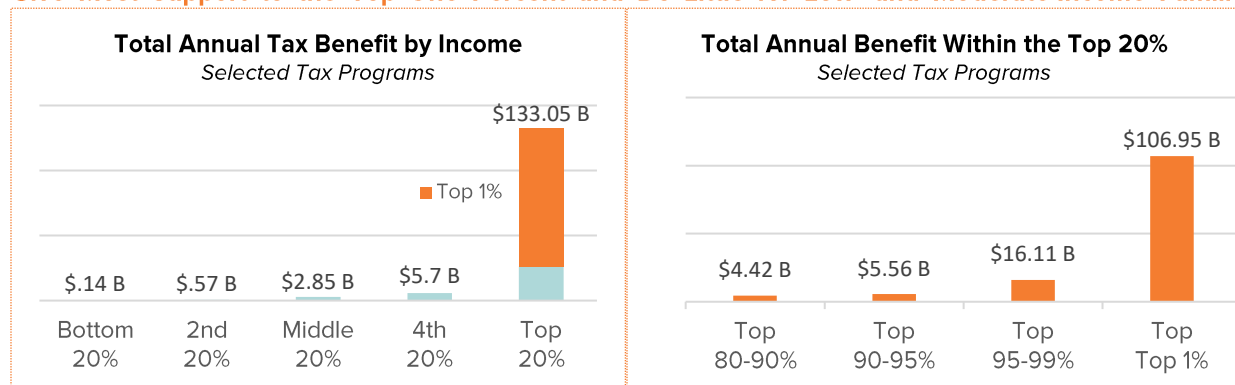
Whether for an unexpected emergency, a home purchase or a secure retirement, saving is the bedrock of financial stability and the foundation for building long-term wealth. Unfortunately, as the COVID-19 pandemic has made clearer, countless families lack the resources to weather a financial storm, much less to be able invest in long-term, wealth-building activities like homeownership or higher education. To put this into perspective, consider that while nearly three-quarters of all households in the US have a savings account,³⁶ less than 60% set aside savings for an emergency.³⁷ Worse yet, nearly 40% of all U.S. households—totaling over 45 million³⁸—and 57% of households of color³⁹ are “liquid-asset poor,” meaning they lack the savings necessary to survive for three months at the federal poverty level if they suddenly lost their income.

Part of the problem is that nearly all families experience income volatility from year to year, which can make it more difficult to plan for the future, let alone absorb the impact of an unexpected crisis. Research shows that more than one in five households (20.1%) has experienced their income change from month to month over the past year.⁴⁰ For workers in highly volatile industries, like the service sector, these fluctuations can happen from week to week and can lead to as much as a 34% difference in weekly pay in any given month.⁴¹ More broadly, the limited ability of workers to save for now and for later can also be attributed to the fact that incomes have barely kept up with rising costs—particularly when it comes to housing⁴² and higher education.⁴³ For example, since 1960, median rents and home prices have outpaced the growth of median household incomes by more than two and four times, respectively.⁴⁴

Unfortunately, despite these and other challenges that make it difficult for working families to save, the roughly \$217 billion the federal government spent to boost savings through investments and inheritances went to help wealthy households build more wealth. In fact, looking at the investment income tax breaks alone, we estimate that the bottom 80% of households received just 6.5% (\$9.2 billion) of the \$142 billion in benefits that flowed through these breaks in 2019. By contrast, those in the top one percent received 75% of all the benefits—\$106.9 billion—from these tax breaks that year.

Investment and Inheritances Tax Programs

Give Most Support to the Top One Percent and Do Little for Low- and Moderate-Income Families



Source: Author's estimates based on tax expenditure data from the Tax Policy Center (2017-2019) and the Office of Management and Budget (FY 2021).

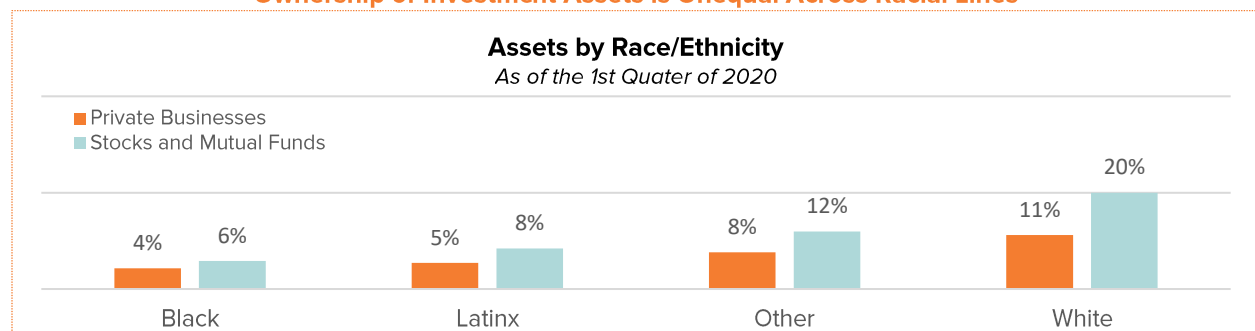
Part of this skew can be attributed to the fact that high-income households generate much of their income through investments. For example, while just under half (46%) of the households in the bottom 80% reported earning investment income in 2018, the rate of those earning investment incomes among households in the top one percent was nearly double (85%).⁴⁵ But the problem is not just that high-income households are more likely to have investment income. It's that their investment income is usually much greater than the investment income of low- and moderate-income households, which in turn leads wealthier households to reap larger benefits from the tax code.

Why? Because flaws in upside-down tax programs that directly tie support to a household's tax rate and the size of their assets ultimately bode well for those at the top. This is particularly true for those in the top one percent, who in 2018 reported an average investment income of more than \$700,000 (households in the bottom 80% had average investment income of less than \$8,500).⁴⁶

For high-income households, investments are fundamentally important. Among the top one percent of households, 53% of their wealth comes from the ownership of investment income assets, such as stocks and private businesses.⁴⁷ By comparison, investment income assets make up no more than 15% of the wealth of households in the bottom 80%.⁴⁸ And when broken out by race, investment income makes up a larger portion of the wealth of White households (31.2%) than for households of color (no more than 20%).⁴⁹

Black and Latinx⁵⁰ households are far less likely to own the types of assets that generate these tax breaks. That is not only because of the systemic factors that lock them out of earning high incomes, but also because those same factors mean that even if they have high incomes, they may have less opportunity to translate those incomes into the types of opportunities.

Ownership of Investment Assets is Unequal Across Racial Lines



Source: Federal Reserve Distributional Financial Accounts.

A similar story emerges for inheritances. In 2018, the top 10% of taxpayers accounted for over 90% of all estates that were large enough to be taxable, with the top one percent accounting for nearly 40% of that figure.⁵¹ Unsurprisingly, higher-income households also have the largest inheritances. In 2016, for example, the average inheritance for someone in the top one percent (\$1.5 million) was almost eight times as large as someone even in the 80% to 90% income percentile range (\$188,800), and larger still than the earners below the eightieth percentile.⁵²

In addition to the disparities between low-income and high-income households, there is a gap between White households and households of color with respect to inheritances. Transfers of wealth between generations can be key to investing in assets, such as higher education and homeownership, but since households of color have less wealth than Whites, they are less likely to receive money from their relatives.⁵³

To this point, the 2016 Federal Reserve’s Survey of Consumer Finances showed that 26% of White families received an inheritance from relatives, compared to just eight percent of Black families and five percent of Hispanic families.⁵⁴ Considering that the 2017 tax law further weakened the estate tax,⁵⁵ the potential for White households to build upon the generational advantage they have long held has only expanded in recent years.

Homeownership

Homeownership can be risky, but it has long been held up as a powerful wealth-building strategy for many low- and moderate-income households. As a forced savings mechanism, the process of making monthly mortgage payments and paying down the principal on a loan, along with modest home appreciation,⁵⁶ leads homeowners to accumulate wealth over time. Research also suggests that homeownership is linked to positive impacts on communities and families, including lower crime, higher community engagement and greater academic achievement.⁵⁷ Taken together, this may explain why more than three-quarters of Americans believe that owning a home is an important part of the American Dream.⁵⁸

Unfortunately, despite the socioeconomic benefits of homeownership and its strong association with the American Dream, access to this important asset is unequal across income and racial lines. For example, although homeownership makes up nearly half (46.1%) of all the assets held by the bottom 20% of income earning households,⁵⁹ less than half of these households (41.6%) are homeowners.⁶⁰ By comparison, although homeownership accounts for about a quarter of the assets held by the top 20% of households,⁶¹ the homeownership rate among this group is over 85%.⁶²

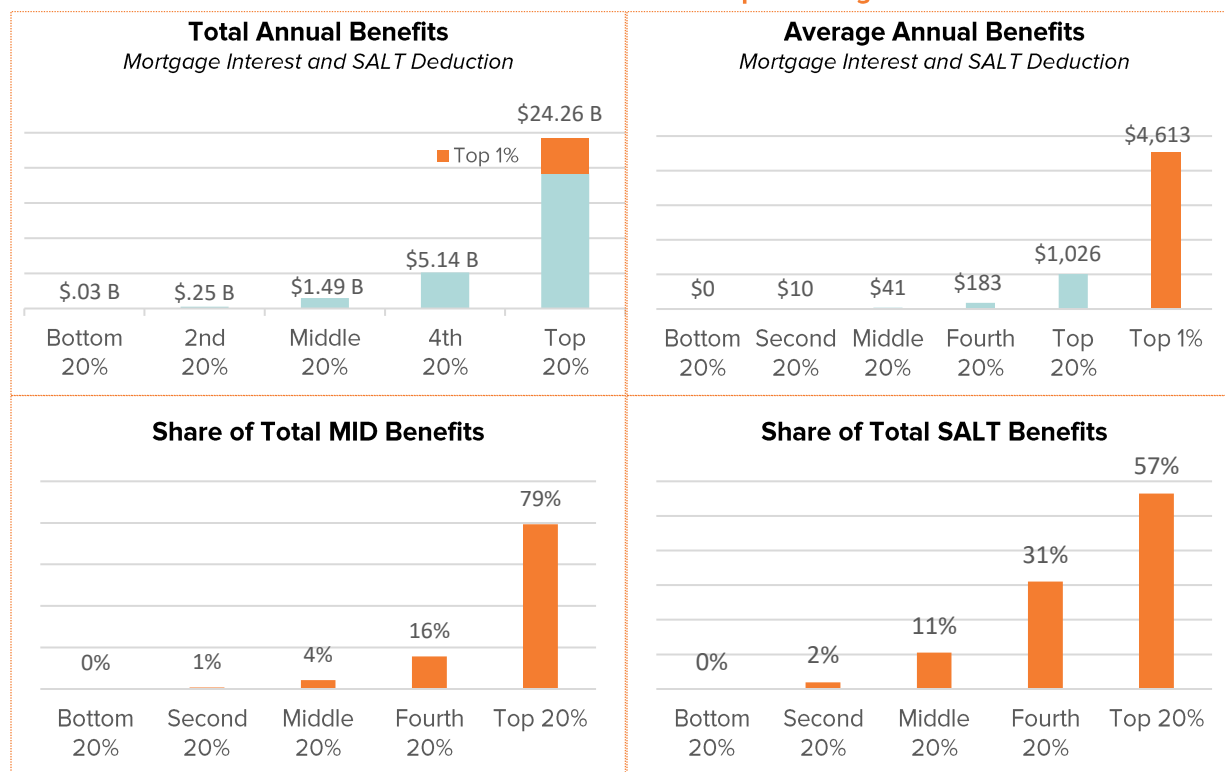
Broken out by race, 72% of White households are homeowners while only 47% of households of color are homeowners.⁶³ These disparities stand in stark contrast to the outsized role that homeownership plays in the wealth of communities of color. The home can account for as much as 36% of the assets held by households of color—a substantial difference compared with White households where the home accounts for about 24% of their assets.⁶⁴ While some of these inequities are connected with our country’s public and private history of discrimination in the real estate market,⁶⁵ they are also interconnected with fact that many low- and moderate-income households, and especially households of color, lack the resources to weather a financial crisis, much less to purchase a home.

Unfortunately, as with the hundreds of billions spent to boost savings, the roughly \$198 billion the federal government spent in 2019 through homeownership tax programs to support this critical wealth-building asset did little to support low- and moderate-income homeowners and would-be homebuyers.⁶⁶ For example, while the 2017 tax law curbed the cost of two of the most prominent homeownership tax programs—the MID and the SALT deduction—collectively, they still cost the federal government an estimated \$31.1 billion in 2019.⁶⁷ Yet, from that massive amount, most recently available data from the Tax Policy Center suggest that

the top 20% of households—those earning \$153,000 or more—receive about 78% of these benefits, while middle-income families receive less than five percent (4.8%) of these benefits.⁶⁸

At the same time, the data also suggests that while the top one percent of households—with incomes of more than \$750,000—receive an average benefit of about \$4,600 (adjusted for inflation) from these programs, the bottom 20% of households—with incomes of less than \$25,000—receive no support at all.⁶⁹ In other words, those who need the most help affording homeownership receive the least support.

Who Benefits from Homeownership Tax Programs?



Source: Tax Policy Center, Model Estimates for Itemized Deductions for Home Mortgage Interest and Property Taxes (T18-0175, T18-0167, T18-0171) and Office of Management and Budget, Tax Expenditures (FY21). Average benefits are inflation-adjusted to 2019 dollars.

It should be noted that while the MID and SALT deduction caps imposed by the 2017 tax law have managed to mitigate some of the inequity in these programs, changes made to the overall tax code have led these benefits to be more heavily concentrated among wealthy households, who are not only more likely to itemize their deductions but also able to more fully claim these benefits. In fact, because of the doubling of the standard deduction and the \$10,000 SALT deduction cap, the MID is now more inequitable than the SALT deduction. Still, more than half of all the dollars that flow through the SALT deduction go to the top 20% of households.⁷⁰

Ultimately, although the MID and SALT deduction represent just a fraction of the nearly \$200 billion spent each year through the tax code to support homeownership, these programs are emblematic of other

homeownership tax programs that do little to support low- and moderate-income homeowners. Even worse, at a time when median rents continue to outpace median income⁷¹ and when nearly half of all renters are spending nearly a third of their income towards housing costs,⁷² these programs provide no support to distressed renters or to would-be homebuyers.

Retirement

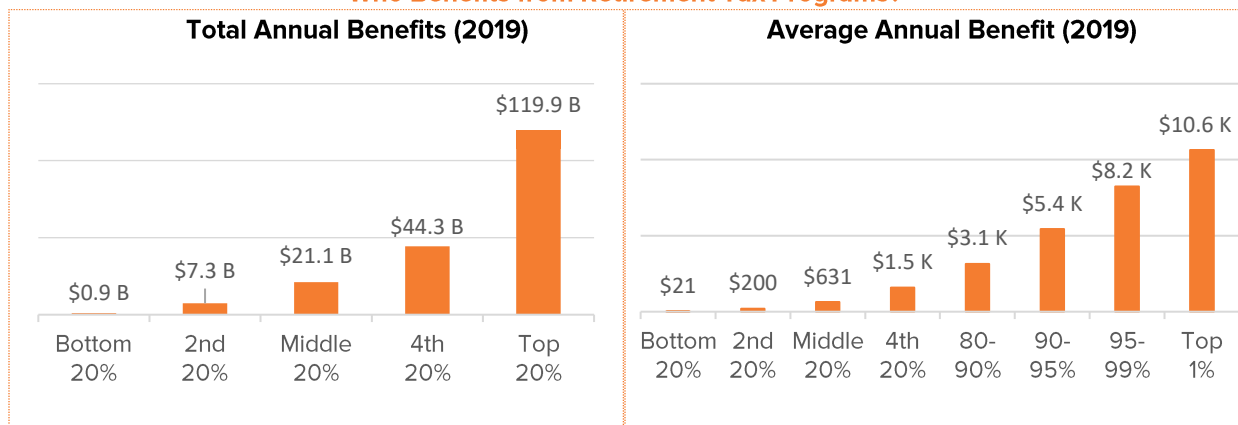
All workers should have the opportunity to enjoy their golden years in dignity and comfort. But unfortunately, many are falling short of achieving those aspirations. Underscoring this reality, 31% of workers say they are not confident they will have enough money to retire,⁷³ nearly half of all families have no retirement savings at all⁷⁴ and among those that are saving, the median working family has less than \$8,000 set aside in a retirement account.⁷⁵ At the same time, while Social Security provides critical support for millions of retired Americans, this program alone usually does not allow low- and moderate-income individuals to maintain their standard of living in retirement.⁷⁶

Put simply, America is facing a retirement security crisis, and those least prepared to deal with it are low-income households and households of color.

According to recent data by the Federal Reserve, while 88% of working-age families in the top 20% of households have savings in retirement accounts, just 13% of working-age households in the bottom 20% have savings set aside in these accounts.⁷⁷ Broken out by race, White households are far more likely to have retirement account savings (68%) than Black (41%) and Hispanic households (35%),⁷⁸ and have, on average, more than five times as much in liquid retirement savings (\$157,884) than Black (\$25,212) and Latinx (\$28,581) households.⁷⁹

These disparities can be attributed to several issues, including that over one-third of workers do not have access to a retirement savings plan through their employers,⁸⁰ and that workers of color are less likely to have access to⁸¹ and participate in employer-sponsored retirement plans.⁸² More broadly, driving these disparities in access and resources further is the reality that too often working families are struggling not just with long-term savings, but with short-term savings as well. Unfortunately, despite the countless challenges facing workers in saving for retirement, a large majority of the roughly \$193 billion spent on retirement savings programs goes to the highest-income households.

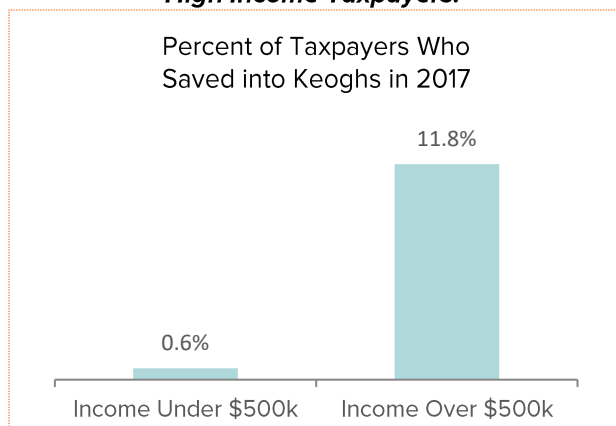
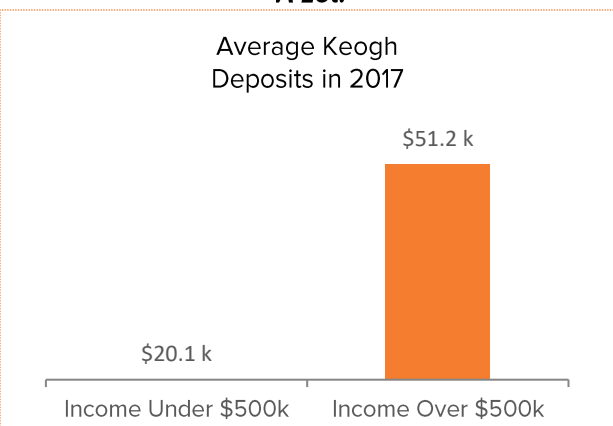
According to an analysis by the Tax Policy Center of spending on IRAs, Saver's Credit, Keogh, defined benefit (DB)—often referred to as “traditional pensions”—and defined contribution (DC) plans—which include 401(k)s other similarly structured plans—in 2017, 62% of the dollars that flowed through these programs went to the top 20% of households.⁸³ Households in the bottom 20% received about one percent of the support from these retirement tax programs.⁸⁴ On average, while households with incomes less than \$50,000 receive \$200 (adjusted for inflation) from retirement tax programs, those in the top one percent received an average benefit of more than \$10,000 from these same programs.⁸⁵ In short, the primary impact of these tax programs is to help the wealthy build more wealth.

Who Benefits from Retirement Tax Programs?

Source: Tax Policy Center, Model Estimates for Itemized Deductions for Home Mortgage Interest and Property Taxes (T17-0130) and the Office of Management and Budget, Tax Expenditures (FY21). Average benefits are inflation-adjusted to 2019 dollars.

Digging deeper, Keogh plans are particularly upside down. This is because they are administratively burdensome compared with other retirement savings options and because high-income households can make the most of this federal tax incentive since they can max out their deposits into these accounts. As a result, Internal Revenue Service (IRS) data reveals a program that is even more upside down than other retirement tax spending programs.

According to the IRS, in 2017 just 0.6% taxpayers with incomes less than \$500,000 reported deposits in Keogh plans, compared to nearly 12% for those with incomes above \$500,000.⁸⁶ In addition, while taxpayers with income below \$500,000 reported saving an average of about \$20,000 in Keogh plans in 2017, filers with income above \$500,000 saved, on average, about \$51,000 that year—an amount strikingly close to the 2017 maximum Keogh contribution limit of \$54,000.

Keogh Retirement Plans**Who Saves into Them?
High-Income Taxpayers.****How Much Do They Save?
A Lot.**

Source: Author's calculations based on data from IRS Statistics of Income (2017).

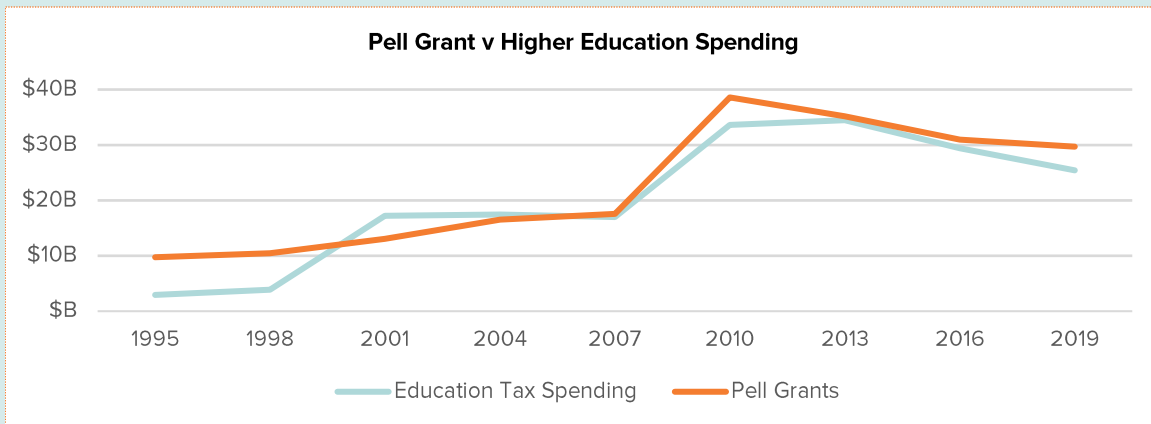
Higher Education

As a nation, we believe in the transformative power of higher education. Not only is it one the surest pathways out of poverty, it is also one of the most effective strategies for building wealth.⁸⁷ And though various studies have shown that it may not be the great equalizer it is often touted to be,⁸⁸ higher education remains a powerful tool for bridging the gap between White households and households of color. In other words, despite its shortfalls and challenges—including rising costs—there is perhaps no better investment working families can make than to invest in the talents and aspirations of their children through higher education.

In recognizing the power and promise of higher education, over the past several decades, our federal budget has devoted large sums to helping millions of students afford higher education. In 2019, for example, the federal government spent more than \$55 billion in non-loan aid to help students pay for higher education. However, while nearly \$30 billion of that was spent on Pell grants⁸⁹—which effectively target aid to working families and students, especially students of color⁹⁰—the \$25 billion spent through federal higher education tax programs did little to support students who need support the most.

The Growth of Higher Education Tax Programs

Although most higher education tax spending programs came into existence only in the last 25 years, they have grown quickly. Between 1995 and 2019, Pell Grant spending increased by just over 200% (adjusted for inflation), while higher education tax spending increased more than 750%. Given this rapid pace of expansion, tax spending on higher education has regularly matched or exceeded Pell Grant spending since the early 2000s.



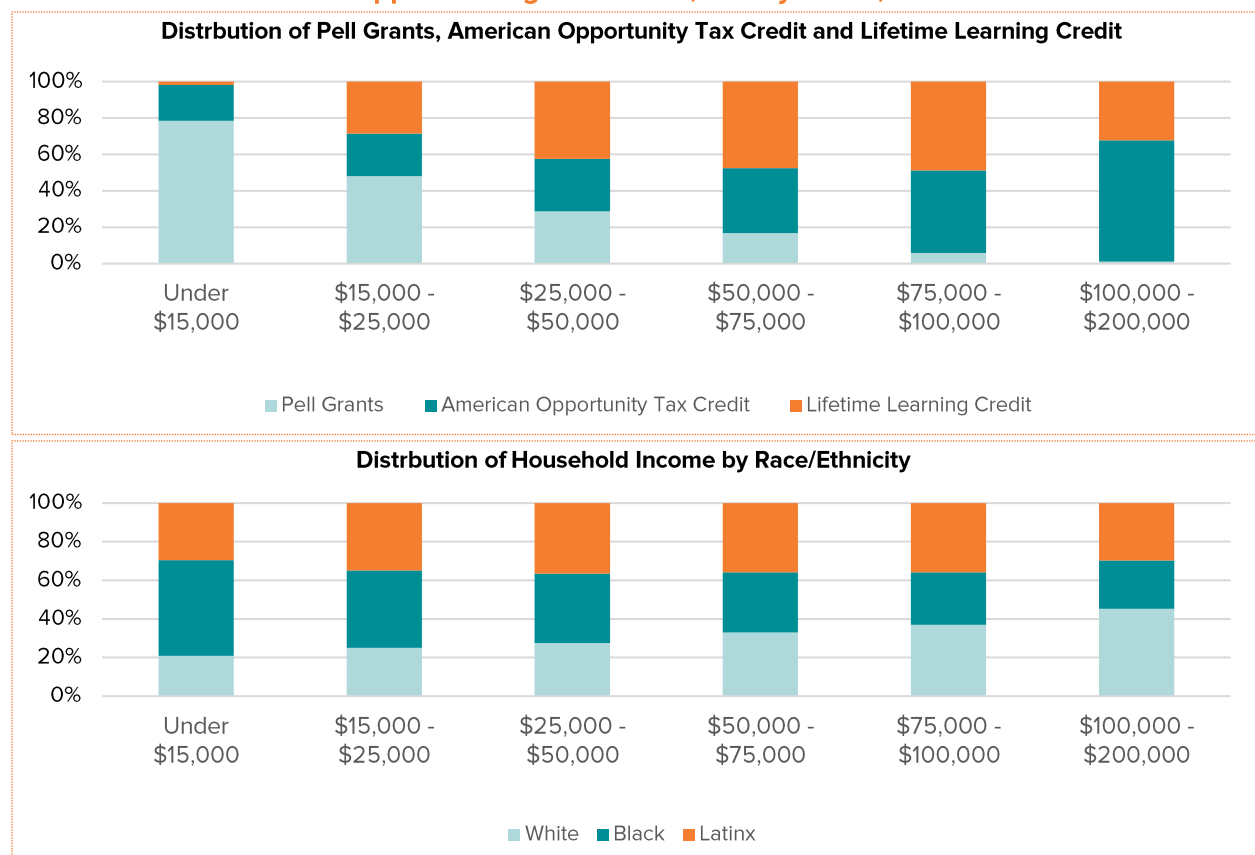
Source: Author's calculations based on OMB data for fiscal years 1997, 2000, 2003, 2006, 2009, 2012, 2015, 2018 and 2019. Inflation adjusted to 2019 dollars. Where applicable, tax expenditures include the following: exclusion of scholarship and fellowship income, the HOPE tax credit, the Lifetime Learning Credit, the American Opportunity Tax Credit (including refundable portion), Coverdell Education Savings Account, 529s, deduction for student loan interest, deduction for higher education expenses, parental personal exemption for students and exclusion of employer-provided educational assistance.

In 2019, the two largest sources of higher education tax spending—the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC)—cost the federal government nearly \$20 billion. But when compared to the Pell Grant program, these higher education tax spending programs were far less focused on expanding opportunity for low- and moderate-income families and students.

According to the most recent estimates from the Tax Policy Center, while about 90% of Pell Grant spending goes to households earning \$50,000 or less, only about half of the support provided through the AOTC and LLC went to these households.⁹¹ Moreover, the larger of these programs, the AOTC, was estimated to have provided roughly a quarter of its support to households earning more than \$100,000, despite the fact that this group makes up just 13% of all tax returns.⁹²

Beyond the fact that the higher education tax programs provide greater support to higher-income families and students, these programs also tend to overlook Black and Latinx households that are more likely than their White peers to earn low and moderate incomes.

Higher Education Tax Spending Focuses Support on Higher-Income, Mostly White, Households



Source: Tax Policy Center, Model Estimates for Current Law Distribution of Tax Units Receiving Pell Grants, AOTC and LLC (T18-0244) and Census Bureau, Income and Poverty in the United States: 2018 (Table A-2)

Beyond this, the structure of 529s and Coverdells—which are tax-advantaged savings accounts created in mid-1990s to increase college savings that have grown rapidly since the early 2000s—also tilt benefits toward high-income, mostly White, households. In fact, while both allow for withdrawals used to pay for K-12 and higher education expenses and function similar to Roth IRAs—meaning that accounts grow tax free and qualified withdrawals are not counted as taxable income—these accounts do little to help most working families save for college as their benefits accrue at the top of the income distribution. Why? Because these benefits take the form of deductions and exclusions rather than refundable credits, so higher-income families who have greater tax liability receive greater tax benefit. Several features of 529s—including minimum deposits and account fees—act as barriers to low- and moderate-income families. While several states have reformed 529s to help close the gap in college savings, these federally supported savings accounts are, by and large, still structured to widen the college savings gap, helping the wealthy grow their wealth further while doing little for most working families.

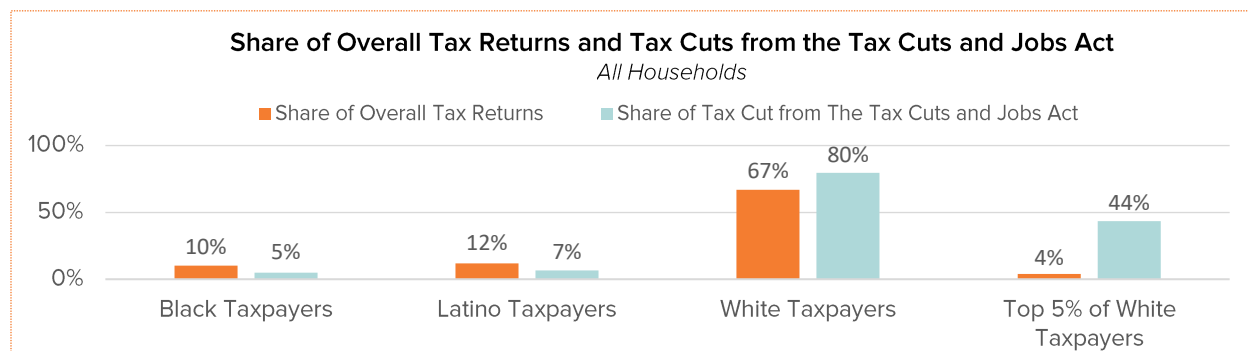
Underscoring this, multiple studies⁹³ have found that while few households use these accounts, those that do are overwhelmingly high-income. For example, examining data from the 2013 Survey of Consumer Finance, the Tax Policy Center found that, despite making up six percent of all households, those with incomes over \$200,000 held 40% of all 529 accounts and 70% of the balances in 529 accounts.⁹⁴ A similar study of 2013 Survey of Consumer Finance data by the Government Accountability Office (GAO) found that among families with 529s or Coverdells then, 84% were White households; just five percent were Black households.⁹⁵ Today, these disparities remain: a 2018 study conducted by Sallie Mae found that White parents were about 60% more likely than Black and Latinx parents to use a 529 or Coverdell to save for their child's education.⁹⁶

4

How Most Tax Policies Leave Communities of Color Behind: The MID vs. the EITC and the CTC

As we raised earlier, on its surface, the federal tax code is race neutral as it does not explicitly take race into account. However, as the Roosevelt Institute,⁹⁷ the National Women's Law Center⁹⁸, the Center on Budget and Policy Priorities (CBPP),⁹⁹ the Tax Policy Center¹⁰⁰ and others have shown, even while being progressive—meaning that it modestly works to close income and wealth gaps—the federal tax code has long featured visible and hidden rules that tilt our nation's largest wealth-building tool towards White, and wealthy, households.¹⁰¹

Research conducted by Prosperity Now and the Institute on Taxation and Economic Policy (ITEP) on the 2017 tax law—representing the most significant overhaul of the tax code in decades—found that 80% of the dollars that flowed through the law went to White households.¹⁰² By contrast, Black and Latinx households—which account for about 30% of the population—received just 12% of those dollars. At the same time, the top five percent of White households received 44% of the 2017 tax law dollars, despite making up just four percent of taxpayers.



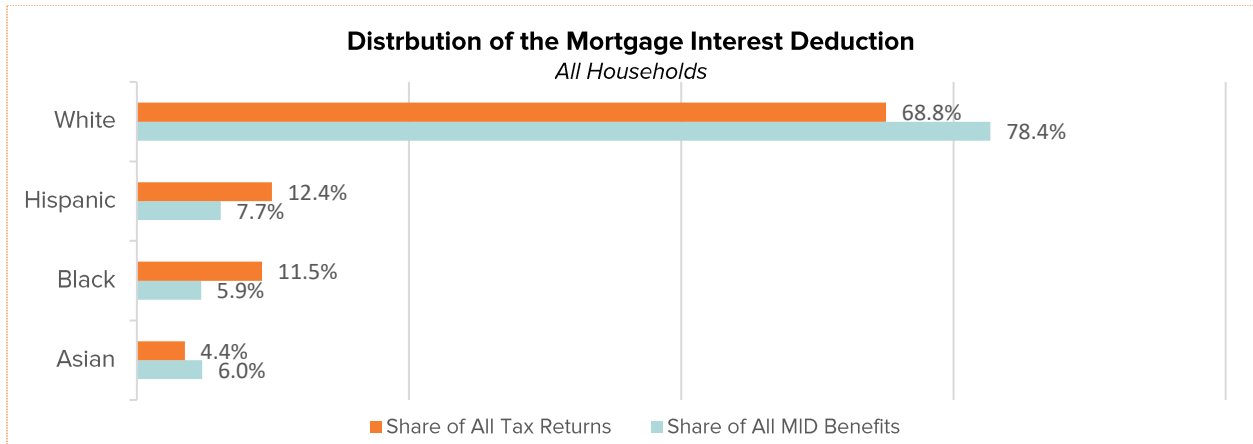
Source: ITEP and Prosperity Now, [*Race, Wealth and Taxes: How the Tax Cuts and Jobs Act Supercharges the Racial Wealth Divide*](#)

While the four flaws we listed earlier play a significant role in who benefits most from the federal tax system, the disproportionate access communities of color face when it comes our tax code can be directly traced to systemic racism and economic barriers that have left these communities at severe disadvantages across a range of social and economic indicators. This includes lower homeownership rates, the results of generations of public and private discrimination in the real estate market. It also includes discrimination in the employment market against communities of color, which has contributed to pay disparities, made it more likely they would work in jobs that pay wages at or below the federal minimum wage and increased the chances they would face historically higher rates of unemployment.

When combined, these disparities and the way tax programs—such as the MID, the EITC and the CTC—are designed can lead to widely different outcomes for White households and communities of color.

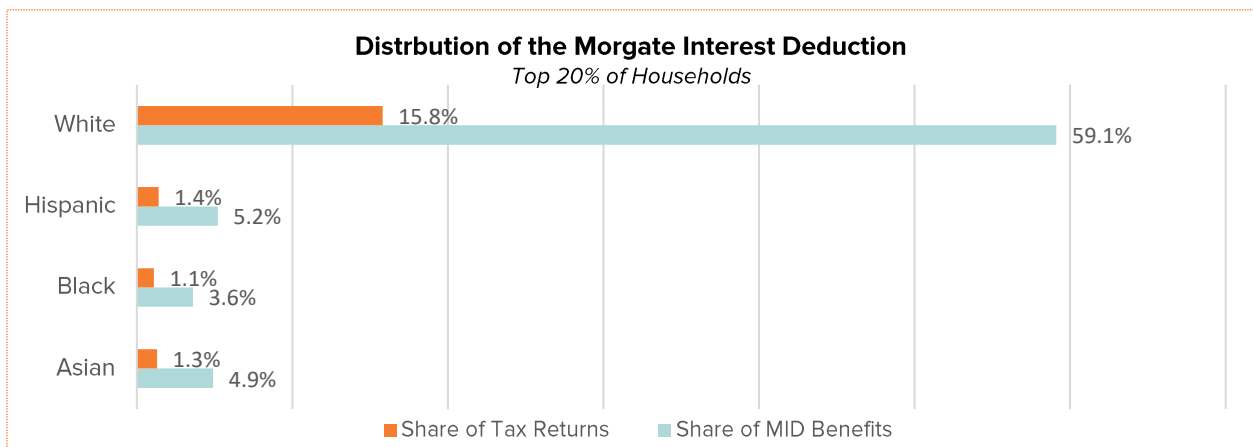
Mortgage Interest Deduction

Taken together, upside-down provisions within the overall tax code serve not only to drive overall economic inequality, but also to widen long-standing inequities facing communities of color. For example, the 2017 tax law made significant reforms to the MID. Yet recent estimates produced by the ITEP¹⁰³ show that the MID continues to disproportionately benefit White households, as 78.4% of its benefits goes to this group alone, despite making up about 68.8% of all tax returns. By contrast, despite making up 28.4% of all tax returns, Asian, Black and Hispanic households receive 19.6% of the MID's benefits.



Source: ITEP Microsimulation Tax Model

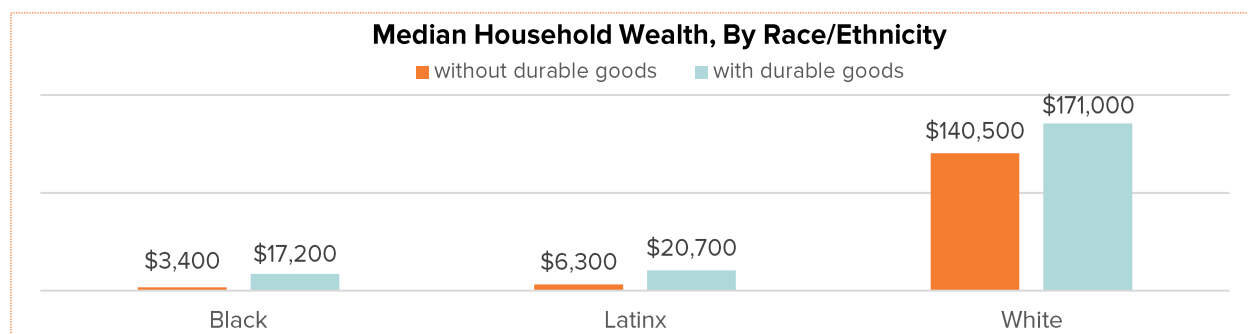
It should be noted that most of these benefits are heavily concentrated among the top 20% income tier of Asian, Black, Hispanic and White households. However, even among this top tier, the MID disproportionately supports White homeownership over homeowners of color. For example, although the top 20% of White households make up 15.8% of all tax returns, they receive 59.1% of the MID's benefits. In contrast, the top 20% of Black and Hispanic households, which make up 2.5% of all returns, receive 8.8% of the MID's benefits. Asian households in the top 20%, which make up 1.3% of all returns, receive 4.9% of the MID's benefits.



Source: ITEP Microsimulation Tax Model

As the Institute on Assets and Social Policy (IASP) and the National Low Income Housing Coalition (NLIHC) have shown in their research,¹⁰⁴ part of these disparities is a result of White households being more likely to be eligible for the MID since they own homes with mortgages at higher rates (39.1%) than Asian (26.2%), Black (25.4%) and Hispanic households (29.7%) do. This state of affairs is in turn informed by a range of past and present barriers to homeownership and credit markets—including redlining and credit discrimination—that have been placed in front of Black and Latinx households.¹⁰⁵

Still, considering the more prominent role homeownership plays in the wealth of Black and Latinx communities, and the wide gap in homeownership these communities have long faced, the MID exacerbates an already considerable racial wealth gap. Today, that wealth gap sees Black and Latinx households owning between \$0.03 and \$0.12 in wealth for every dollar owned by White households.¹⁰⁶



Source: With durable goods – Federal Reserve, 2016 Survey of Consumer Finances; Without durable goods – Edward N. Wolff, *Household Wealth Trends in the United States, 1962 to 2016: Has Middle Class Wealth Recovered?*

The Earned Income Tax Credit and the Child Tax Credit

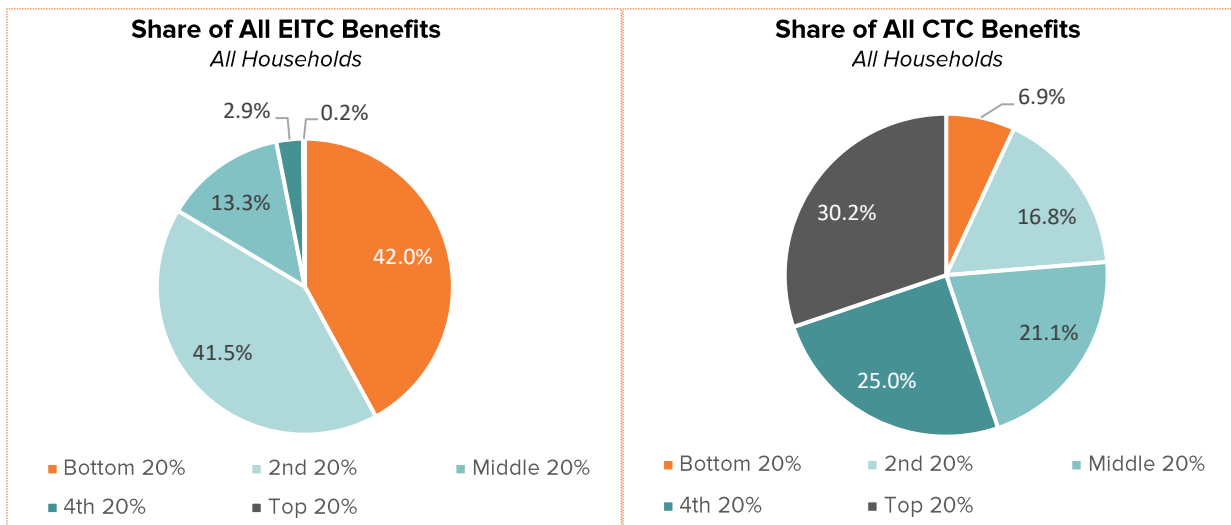
Although most wealth-building tax programs are upside down, there are a few examples of right-side up and equitable policies among these programs. Among these are the largest tax credits available to low-income workers and families: the EITC and the CTC.

While the EITC and CTC differ in several ways, including that the EITC is fully “refundable” and the CTC is partially “refundable”—that is, available as a payment if a household’s income is so low that they owe little or no federal income taxes—together, they are among the most powerful and effective anti-poverty programs in the nation. According to the CBPP, in 2018 the EITC¹⁰⁷ and CTC¹⁰⁸ lifted more than 10 million people, including more than 5.5 million children, out of poverty, while also lessening the poverty experienced by another 29 million people. In total, the EITC and CTC boosted the incomes of more than 28 million poor Americans.¹⁰⁹

In 2019, the EITC and CTC delivered \$183 billion to low- and moderate-income households to help them build financial security and boost opportunity. The impact of this spending was far-reaching, as nearly half of the 155.9 million tax returns filed in 2019 benefited from the EITC and CTC.¹¹⁰ Beyond this impressive reach, the EITC and CTC are noteworthy and meaningful investments because they are designed to focus their

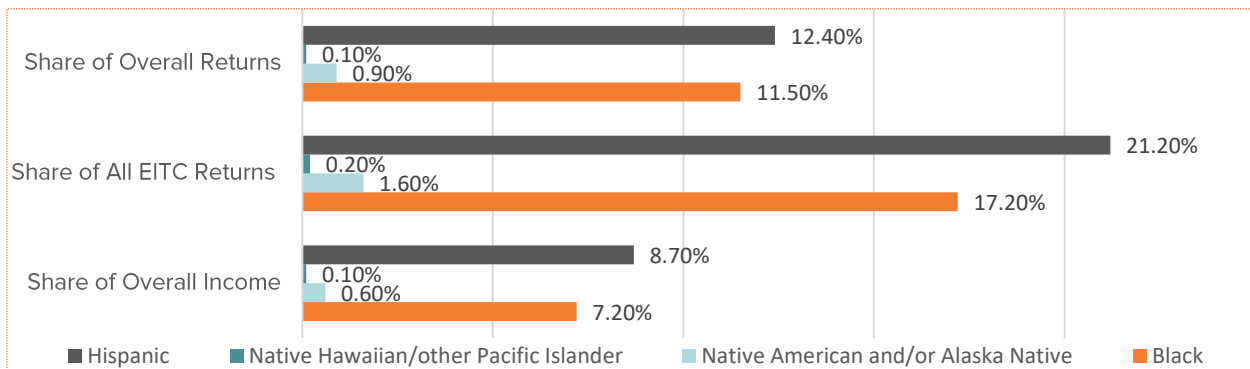
support on those that need it most, unlike investment tax breaks that overwhelmingly support savings among the wealthy.

The CTC is in some ways less progressive than the EITC, however. For example, while the EITC delivers 0.2% of its benefits to households in the top 20% of income-earning households, the CTC delivers 30.2% of its benefits to that highest-income quintile. Among those in the lowest quintile by income, the EITC provides 42% of its benefits, whereas the CTC only provides 6.9% of its benefits to that group. This is in part due to the 2017 tax law, which increased eligibility for the CTC to households with up to \$480,000 in income for a family of four (a married couple and two children).



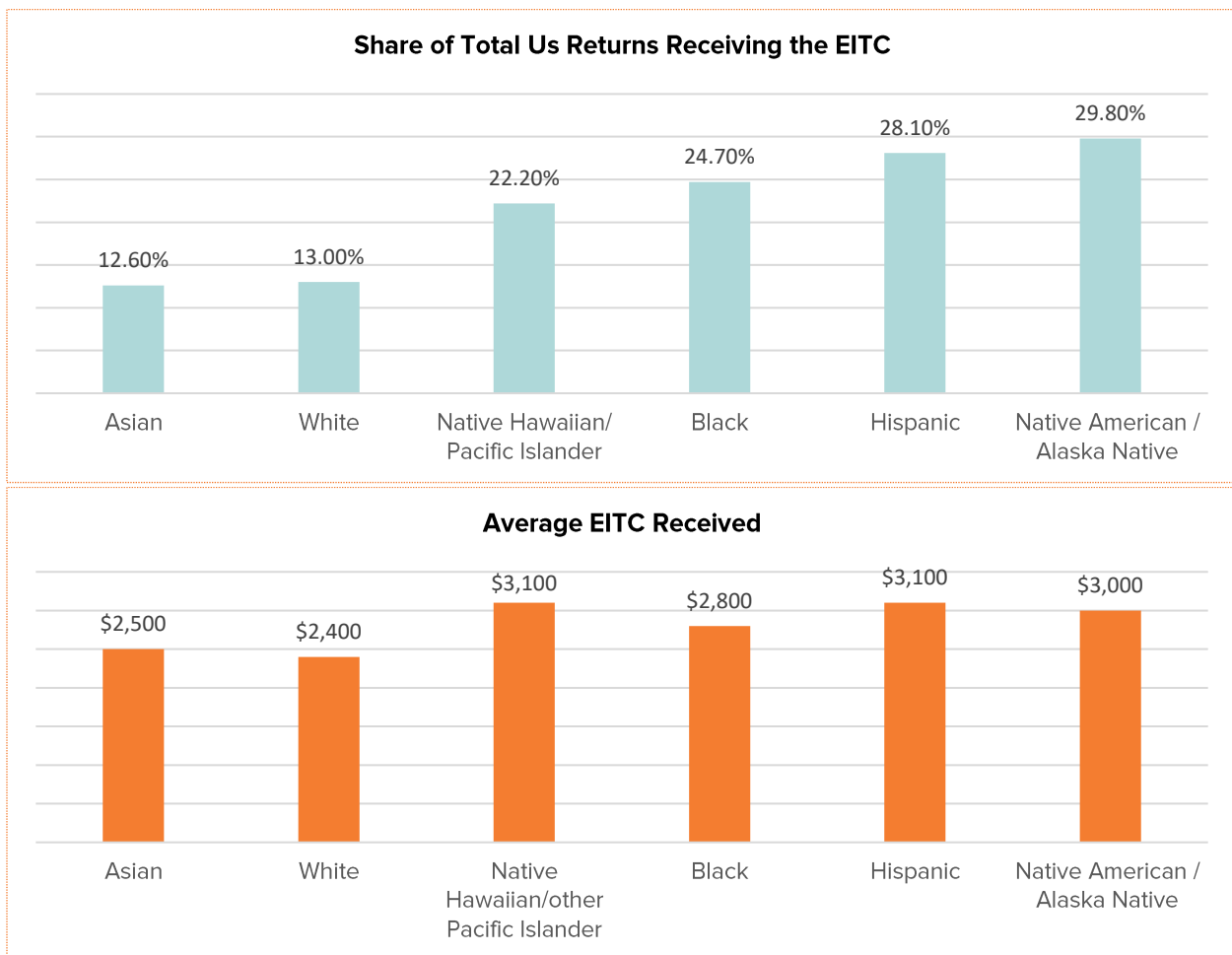
Source: ITEP Microsimulation Tax Model

By race/ethnicity, the EITC greatly benefits Black, Native American and/or Alaska Native, Native Hawaiian/other Pacific Islander and Hispanic households. For example, data compiled by ITEP shows that even though these groups make up about a quarter of all tax returns (24.9%), they account for 40.1% of all the tax returns that claim the EITC.¹¹ This is particularly important considering that as a share of the overall income reported through tax returns, the collective income of these taxpayers accounts for about 16%—lower than their share of the overall population.



Source: ITEP Microsimulation Tax Model

Digging deeper, when we look at EITC beneficiaries, Black and Latinx households—who are more likely to earn lower wages and experience poverty—disproportionately benefit from the EITC. For example, while Black households make up 17.2% of those claiming the EITC, they receive 18.1% of the total benefits of all EITC benefits. Similarly, while Hispanic households make up 21.2% of those claiming the EITC, they receive 24.6% of all EITC benefits. Overall, however, the racial/ethnic group most likely to benefit from the EITC is Native American and/or Alaska Native households, among whom 29.8% claim the EITC (Hispanic and Black households are respectively the second and third most likely to claim the EITC at 28.1% and 24.7, respectively). And in terms of dollars, these three groups receive higher than average amounts of the EITC (\$3,000, \$3,100, and \$2,800, respectively) compared to the overall population (\$2,700) and White households (\$2,400).



Source: ITEP Microsimulation Tax Model

5 Federal Policies to Turn Upside Down Spending Right-Side Up

Tax programs that boost and promote savings, homeownership, retirement and higher education have long been upside down. With the passage of the 2017 tax law, these and other tax benefits now tilt even further in their support of helping high-income, wealthy and mostly White households grow their wealth. We believe that the government *should* be helping families—especially working families and families of color—build financial security. Moreover, we also believe that the flaws discussed above can be fixed.

While countless reforms have been proposed for the programs highlighted in this paper, we offer the following reforms as examples that creating right-side up tax policies is not only possible, but that it can be done by redirecting existing upside down tax spending. These policies would also help state tax codes—which have historically been more regressive and that automatically hook up their income taxes to the federal code—move in the right direction. However, to ensure that their tax systems help those that need the most support, states will also have to eliminate and restructure regressive tax codes and tax breaks, as well as enact or boost their own versions of the EITC and CTC, among other programs.

Savings

Expand and strengthen the EITC and CTC for working families.

As we detailed earlier, the EITC and CTC are among the nation's most powerful and effective anti-poverty programs, lifting more than 10 million of people out of poverty and lessening the poverty experienced by an additional 17.5 million people in 2018 alone. Yet, despite their success, gaps in both programs limit their potential to help individuals and families build savings and long-term financial security.

To address these gaps, Congress could enact the **Working Families Tax Relief Act**, which would nearly quadruple the maximum EITC credit for childless workers (from \$529 to \$2,040), expand the eligibility age range of the credit from 25-64 to 19-67 and increase the maximum credit families with children could receive by about 25%. In addition, the Working Families Tax Relief Act would also make the CTC fully available, meaning that even the poorest families with no earnings would be eligible to receive the full \$2,000 benefit. It would also create an additional \$1,000 refundable tax credit for households with children under six.

Glaring Gaps in the EITC and CTC Limit Their Effectiveness

Workers not raising children in the home receive little or no support from the EITC.

Workers below the age of 25 and over the age of 65 are excluded from accessing the EITC.

Low and moderate-income families do not fully benefit from the CTC because the credit's refundable portion is limited to \$1,400 per child, instead of full \$2,000 value of the credit.

American Families in Puerto Rico face disparities in accessing the EITC and CTC.

Restrictions limit access to the EITC and CTC for working immigrant families.

Source: Prosperity Now, [Enhancing Tax Credits for Working Families](#); Center on Budget and Policy Priorities, Policy Basics: [The Earned Income Tax Credit](#) and [The Child Tax Credit](#).

Estimated to cost about \$1 trillion over a 10-year period, close to 90% of its cost—\$876.9 billion¹¹²—could be paid for simply by closing the rule that allows inherited assets to sidestep capital gains taxes. By redirecting these dollars that go to helping the wealthy build more wealth, the Working Families Tax Relief Act would not only more equitably distribute tax benefits than the 2017 tax law did—both by income and race¹¹³—but would also be able to raise the incomes of roughly 46 million households.¹¹⁴ Finally, it would reduce the poverty experienced among Black¹¹⁵ and Latinx¹¹⁶ households by about 20%.

Enacting expansions, such as the Working Families Tax Relief Act, is a step in the right direction from a racial equity perspective. Because of systemic barriers to opportunity leading to workers of color disproportionately working for low pay, families of color disproportionately benefit from the EITC and CTC. However, at the same time, Black and Latinx families are disproportionately *left out* of these credits in ways that can be readily fixed. The current CTC is limited to 15% of a family's earnings above \$2,500, so the very poorest families with children are excluded. According to the CBPP,¹¹⁷ a fully available CTC would lift out of poverty one million Black, one million Latinx, 850,000 non-Hispanic White, 120,000 Asian and Pacific Islander and 70,000 Native American individuals, including children. Workers at the bottom of the income scale – particularly workers without children – whose EITC is severely limited are also more likely to be workers of color. Fixing the existing holes in the credits would make the tax code more equitable and help narrow the racial income and wealth gaps.

It is equally important for policymakers to strengthen the EITC and CTC for residents of Puerto Rico through measures such as the Economic Mobility Act. Puerto Rico residents are ineligible for the federal EITC, and only families with three or more children can receive the CTC. Improving access to the federal credits for those on the island would help the Commonwealth tackle its high poverty rate and low labor force participation rate.

Strengthen the EITC to help working families save for the now and later.

At the same time, Congress could enact **Rainy Day 2.0**, an expanded version of the bipartisan Refund to Rainy Day Savings Act.¹¹⁸ Rainy Day 2.0 would tap into the tax time moment—during which refunds can account for as much as one-fifth of annual income¹¹⁹—so that families can save a portion of their refunds for a rainy day right as they are completing their taxes. This proposal would make it possible for tax filers to defer 20% of their tax refund for six months—which would accumulate interest—before being deposited back in the filer's account.

In addition, working families who qualify for the EITC would also receive a 50% match on top of their deferred portion to inspire them to put aside some of their refund. Considering that nearly one in every four people in the country are unable to come with \$400 to pay for an emergency without borrowing or selling something,¹²⁰ and that a majority of households of color are one unexpected financial emergency away from economic ruin, Rainy Day 2.0 could greatly help working families to have an emergency fund to draw on throughout the year. Estimated to cost \$867 million per year,¹²¹ such a proposal could be funded easily by reforming the “carried interest rule,” which is estimated to cost \$1.4 billion in 2020.¹²²

Homeownership

Help low- and moderate-income families build a pathway towards successful homeownership.

Despite the 2017 tax law making significant reforms to the MID and SALT deduction, both programs continue to do little to support low- and moderate-income homeowners. Instead of focusing on one or two solutions that deal with the inequities within these programs, in a four-part housing proposal—*Coming Home: Providing a Pathway to Housing for All*—Prosperity Now has detailed a comprehensive approach that would redirect the tens of billions spent through the MID and SALT deduction to not only address the cost of housing for low- and moderate-income families at different points, but also to reduce the near- and long-term financial burdens caused by ownership and support distressed renters.¹²³ Taken together, the following four solutions would create a pathway to stable housing that lasts a lifetime:

- Create a Low-Income Renters' Credit to Support Distressed Renters:** Unlike existing homeownership tax programs, which overlook renters entirely, Prosperity Now has called for providing a tax credit to low-income households that are at 80% area median income (AMI) or less who are also rent-burdened, spending 30% or more of their income on rent. Specifically, as outlined in our proposal *Coming Home: Providing a Pathway to Housing for All*, eligible households would receive between \$1,000 and \$3,000 from the newly created renters' credit, with greater amounts going to families with higher burdens. Because the credit is refundable, households who do not pay any federal income tax would be able to take the full credit, which is especially helpful for low-income households. The credit can be taken annually as well, meaning the benefit is available each year an eligible household is renting. Savings from this credit could help pay off debt, save for a rainy day or set aside money for a down payment.
- Help Families Save for a Down Payment Through Matched Savings:** Saving enough money for a down payment is usually the greatest obstacle to homeownership that people face. To help low- and moderate-income households save for this significant payment, a matched savings program should be established for low-income families at 80% AMI or less. Families who set aside up to \$2,000 of their own money over a two-year period would have their contribution matched dollar-for-dollar by the federal government. This means if a household saves the full \$2,000, they will end up with \$4,000 for a down payment. Households could save more of their money if they wish and could supplement these federal dollars with other down payment assistance programs.
- First-Time Homeowners Credit:** A tax credit for low-income, first-time homebuyers would help pay for expenses created by the purchase of a home by recouping some of the closing costs during tax time. The First-Time Homebuyer Tax Credit was temporarily enacted after the financial crisis in 2008 and proved to be more equitable than the MID and the SALT deduction, with most benefits going to low- and moderate-income families. This reinstated program would provide a refundable credit of up to \$6,000 to households at 80% AMI or less and would be available during the first tax filing period following the purchase of the home. For properties valued at \$60,000 or less, the amount of the credit would be capped at five percent of the purchase price.

- **Homeowners Post-Purchase Tax Credit:** Lastly, a refundable credit of \$1,200, available to all households with mortgages, would help defray the costs, like repairs, associated with long-term homeownership. This tax credit could be taken every year during tax filing season and would be for the same flat \$1,200 amount, regardless of income level. This universal tax credit would allow households that can no longer take the MID and SALT deduction to receive some tax benefit from ownership.

Retirement

Create a universal, simple, safe and affordable retirement savings account for all households.

As important as federal savings incentives are, they are of little use to workers who have no access to a retirement savings account. To address this, Congress could enact the **Saving for the Future Act**, which would create a universal retirement savings plan with three basic features:

- **Automatic Enrollment.** When workers are automatically enrolled in retirement plans, they don't have to do anything to start saving, and the option to opt out always remains. Studies show that automatic enrollment can increase participation rates from 40% to over 90%.¹²⁴
- **Employer Contributions.** Employers must do their fair share to help their employees save for retirement. Building upon proven models of workplace retirement savings, such as 401(k)s, DB pensions and emerging state-backed savings plans, employers should contribute for every hour worked by their employees to a retirement account, which would ensure that workers will have a minimum amount of savings available to them, regardless of whether they contribute.
- **Emergency Savings at Work.** To build emergency savings, part of what a worker puts aside should go to a safely invested, accessible account designed for short- and medium-term savings. Additional contributions can then go to a worker's retirement fund and help the employee save for their future.¹²⁵

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In short, the Saving for the Future Act would not only help workers save for retirement, but also would support them in saving for emergencies—a first step in saving for the long term.

Reform and improve the Saver's Credit to better serve working families.

The Saver's Credit is an exception to the upside-down picture that accompanies most retirement tax incentives. The most recent IRS data shows that in 2017, every dollar spent through the Saver's Credit (\$1.5 billion) went to households with incomes under \$75,000¹²⁶. But the program's impact is limited by its non-refundability so, individuals with no income tax liability—common among low- and moderate-income tax filers—cannot receive the maximum credit.

To address this, Congress should make the Saver's Credit fully refundable so that all working families—regardless of whether they owe income tax—can receive support for retirement savings. Also, Congress

should simplify the benefit levels and provide the credit as a savings match, which would more effectively encourage low- and moderate-income families to save for retirement.

Higher Education

Provide every child with a Children's Savings Account.

The 529 program has notable goals, but its structure has mostly served to help the wealthy build up considerable tax-free nest eggs for their children's future, while doing little to help low- and moderate-income families save and invest in the future of their children. Given that nearly 40% of all families lack the savings to survive at the federal poverty line for three months in the event they lose their ability to earn an income,¹²⁷ it is hard to imagine that working families would be able to fully take advantage of such programs.

Instead of spending enormous sums to help wealthy families pay for private K-12 and higher education tuition tax free, we could provide meaningful and tangible support for the educational aspirations of low- and moderate-income families and children. For example, by redirecting just a fraction of what we spend on upside-down higher education tax programs—\$500 million—we could provide a \$100 savings account for every one of the four million babies born in this country every year, while also providing matches to help low- and moderate-income families build savings faster. Quadruple that to \$2 billion, and we could provide every child with savings account at birth along with a one-time \$500 deposit—an amount that has been shown to meaningfully raise a child's expectations for their future.¹²⁸

Provide every child with a birthright to capital through Baby Bonds.

More broadly, we could provide low-wealth families with even greater support to ensure that their children have the same opportunities to obtain a higher education and build assets as children born into wealthy families. A prime example of such a proposal comes from the **American Opportunity Accounts Act**, otherwise known as the “baby bonds” proposal, which would provide all children—but especially those from low-wealth families—with the capital necessary to access wealth-building opportunities, such as a higher education or homeownership.

Building on an idea developed and long championed by economist Darrick Hamilton and William “Sandy” Darity Jr., the American Opportunity Accounts Act could provide a low-wealth child with as much as \$50,000 by the time they turn 18. Doing so would not only provide the capital needed for the next generation to access wealth-building opportunities, like higher education or homeownership, but could also significantly bridge the racial wealth gap.¹²⁹ Estimated to cost about \$60 billion a year, such a program could be nearly paid for by reforming the exclusion for inherited investments, which in 2019 cost the federal government \$50 billion, or by reverting the estate tax to the parameters that were in place before 2017.

Conclusion

COVID-19 and the ensuing economic crisis has exposed and put pressure on the financial vulnerability of so many low- and moderate-income families. As we grapple with this crisis, and as we deal as a nation with

Creating a more just and equitable society in which *all*—but especially Black and indigenous people and other people of color—can prosper will require both new investments and a meaningful redirection of existing resources that primarily serve to calcify economic and racial inequality. The \$634 billion spent through upside-down tax programs represents a significant pool of resources that can serve as a down payment to begin remedying the persistent and insidious role of systemic racism in government programs and our tax code. Bringing an end to systemic racism will take many steps, but enacting true racial wealth equity will be an essential one, and that cannot be done without turning all of our public systems right side up—including the tax code right-side up.

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Appendix – Summary of All Cited Tax Expenditures

Unless otherwise noted, the 2019 spending levels detailed below come from the Office of Management and Budget's Analytical Perspectives "[Estimates of Total Income Tax Expenditures for Fiscal Years 2019-2029](#)."

Savings

in 2019, the \$217 billion the federal government spent through tax programs to boost savings through investments and inheritances was allocated across the following programs:

\$142.6 billion – Investment income tax break, also known as the “preferential tax treatment of capital gains and qualified dividends,” allows unearned income, generated through ownership and sale of stocks and other financial assets, to be taxed at lower rates than income earned through wages or salaries. Today, while earned income is taxed at a rate between 10% and 37%, investment income gets preferential treatment, with a top tax rate of only 20. Overall, reduced tax rates on capital gains and dividends cost the federal government \$111.5 billion and \$31.1 billion, respectively, in foregone revenue in 2019.

\$49.9 billion – Exclusion for inherited investments, often called the “step-up basis of capital gains at death,” allows heirs to avoid paying capital gains taxes on the “unrealized” capital gains of assets (the increase in value of an asset from its purchase price) that are passed onto to them. By using the exclusion for inherited investments, estates and heirs avoid paying taxes that would have been otherwise owed if the passed-on asset(s) had been sold by the original owner (heirs are only required to pay taxes on any future appreciation of the asset passed on to them).

	Investment Income Tax Break <i>Preferential Tax Treatment of Capital Gains</i>	Exclusion for Inherited Investments <i>Step-Up Basis of Capital Gains at Death</i>
Income	\$160,726 to \$204,100	
Initial Purchase Value of Asset	\$100,000	
Increased Value of Asset	\$250,000	
“Unrealized” Capital Gains	\$150,000	
Capital Gains Tax Rate	15%	
Tax Due	When immediately Sold by Owner \$22,500	When Immediately Sold by Heir \$0

Source: Author's calculations.

\$20.2 billion – Exclusion of interest on state and local bonds allows the interest investors earn from state and local government-issued bonds to be tax free. In contrast, an investor who purchases a corporate bond does have to pay tax on the interest from those bonds. While this provision helps fund critical public projects, such as roads and schools, these state and local bonds are very popular with private investors (*Tax Policy Center, [Briefing Book: What Are Municipal Bonds and How Are They Used?](#)*).

\$4.5 billion – Other investment tax programs. The above programs account for more than 98% of all federal dollars spent on investment and inheritance tax programs. Two relatively small programs that allow investors to defer tax payments on their investment income account for the remainder:

- **\$3.6 billion – Deferral for investment gifts**, or “carryover basis of capital gains on gifts,” is similar (but much smaller than) to the inherited investment exclusion described above, though instead of the stock being inherited, it is a gift. And instead of the capital gain being excluded, it is just deferred.
- **\$900 million – Deferral of interest on US savings bonds**, which provides bondholders the option of paying income tax on interest earned when they receive it or deferring those payments until they cash in the bond, which can often be decades later.

While the **estate tax** is not usually counted as a tax expenditure (and is not counted in this report as such)—since it does not apply to *income*, but rather, is levied on high-value estates—in recent years the estate and gift taxes have been cut dramatically, which has led to sizable reduction in federal revenues. For example, the recent cut to estate tax as part of the 2017 tax law, which more than doubled the estate tax exemption to \$11.8 million for estates of single filers (\$22.36 million for couples), led to an estimated \$8.1 billion reduction in federal revenue for 2019 (*Tax Policy Center, [T18-0134 - Estate Tax Returns and Liability Under Current Law and Pre-2017 Tax Act Law](#)*).

Homeownership

In 2019, the \$198 billion the federal government spent through tax programs to support homeownership was allocated across the following programs:

\$121.3 billion – Tax preference for homeowners over renters, also known as the “exclusion of net imputed rental income,” allows homeowners to exclude “imputed” rental income—essentially the rent a homeowner pays themselves—from taxable income. By contrast, rent cannot be excluded from landlords’ taxable income. Calculated by the OMB since 2004, this tax break has grown rapidly and is now the most expensive homeownership tax break.

\$43.6 billion – Exclusion of home sale gains, available to both itemizers and non-itemizers, allows an individual homeowner to deduct up to \$250,000 (\$500,000 for couples) in capital gains from the sale

of a principal residence. For example, if an individual buys a home for \$250,000 and sells it for \$500,000, they will pay no capital gains tax on the \$250,000 increase in home value. If they were able to sell the home for \$650,000, they would pay capital gains tax on \$400,000—\$250,000 less than the \$500,000 increase in value.

\$25.1 billion – The Mortgage Interest Deduction (MID), an itemized deduction for interest paid on a principal residence and a second home, has long served to subsidize home debt rather than homeownership. The more debt a homebuyer takes, the more support they receive. Even after reforms were made to the MID as part of the 2017 tax law—which lowered the maximum mortgage interest that homeowners could deduct from \$1 million to \$750,000—the MID continues to be the most prominent tool the government uses to subsidize mortgage debt.

\$6 billion – The State and Local Tax (SALT) deduction, an itemized deduction, allows property owners to deduct state and local taxes paid on owner-occupied homes. While the deduction has existed alongside the MID since 1913 and has been reformed numerous times over the past century (*Tax Policy Center, Briefing Book – How Does the Deduction for State and Local Taxes Work?*), the 2017 tax law capped the deduction at \$10,000 for most households). Before the passage of the 2017 tax law, no cap existed. Ultimately, even with the cap in place, SALT supports buying more expensive homes, as the more property tax a household owes, the more support they receive.

\$2.4 billion – Other investment tax programs. The above programs account for more than 98% of all federal dollars spent on investment and inheritance tax programs. Three relatively small programs that allow investors to defer tax payments on their investment income account for the remainder:

- **\$1.5 billion – Deferral of income from installment sales**, which allows these sellers of homes sold and paid for over the course years, rather than in a single lump sum, to delay paying taxes on profits from the sale of a home.
- **\$690 million – Exclusion of interest on owner-occupied mortgage subsidy bonds**, which allows bondholders of state and local government-issued bonds to finance lower-rate mortgages for low-income and veteran homebuyers, to exclude the interest earned on these bonds from taxation.
- **\$210 million – Discharge of mortgage indebtedness**, which allows homeowners to exclude debt that is forgiven (or “discharged”) through mortgage restructuring or foreclosure from taxation (Estimate cited here is based on OMB figures from 2018 as this provision was extended at the end of 2019, applying to qualified mortgage debt discharged before January 1, 2021).

Retirement

In 2019, the \$193 billion the federal government spent through tax programs to support retirement savings was allocated across the following programs:

\$75.7 billion – Defined Contribution (DC) Employer Plans traditionally allow workers to make “tax deferred” contributions to employer-provided retirement savings accounts, meaning that the pre-tax income deposited into these accounts and accrued gains are taxed when withdrawn rather than when earned. Put differently, traditional 401(k), 403(b), the Federal Thrift Savings Plan, and other similarly structured plans provide workers with an immediate tax benefit for contributions made into their accounts.

In contrast to traditional DC plans, Roth-style DC plans allow workers to use their after-tax income to make contributions, meaning that while workers get no immediate tax benefit for their contributions, these accounts are able to grow tax free and are not taxed when withdrawn. For 2019, annual exclusions were limited to \$19,000 for the employee, and a total of \$56,000 from both the employer and employee (*Internal Revenue Service*, [Retirement Topics – Contributions](#)). Workers must wait until age 59½ to make withdrawals or else face penalties.

\$71.7 billion – Defined Benefit (DB) Employer Plans, often referred to as “traditional pensions,” guarantee workers a steady stream of benefits as long as they are alive. Like DC plans, workers do not pay taxes on DB benefits until they are withdrawn, at which point these benefits are taxed as income. DB plans face maximum annual benefit limits (\$225,000 in 2019) rather than maximum annual contribution limits (*Internal Revenue Service*, [Retirement Topics – Contributions](#)). High-income workers can build up more tax-supported retirement savings by combining a DB plan with an additional DC or IRA plan.

\$24.2 billion – Keogh Retirement Plans were created for sole-proprietors and other small business owners and can be structured as either DB or DC plans. While these plans are considerably more complex than alternative options, they are favored by high-income business owners and self-employed entrepreneurs who can take advantage of the higher contribution limits (up to \$56,000 in 2019).

\$20.5 billion – Individual Retirement Accounts (IRAs) function like DC plans but are usually set up by individuals themselves rather than employers. IRA plans offer greater early withdrawal flexibility for a range of qualifying expenses (e.g. home purchase) and life events (e.g. permanent disability), and also allow workers to rollover savings from a DC plan into an IRA—an approach that represents the largest source of IRA contributions (*Center for Retirement Research at Boston College*, [Who Contributes to Individual Retirement Accounts?](#)).

There are four types of IRAs that offer tax benefits directly to workers; each differs by contribution limit and level of tax benefit:

- **Traditional IRAs**, which are the most common IRA and function similarly to DC plans; allow most workers to deduct contributions of up to \$6,000 (in 2019 and 2020) every year (depending on filing status and access to other employer-sponsored retirement plans; income limits may apply).

- **Roth IRAs**, have the same contribution limit as traditional IRAs, but deposits are taxed as normal income and withdrawals are tax-free (Roth IRAs also face income limits).
- **Savings Incentive Match Plan for Employees (SIMPLE) IRAs**, which provide the same tax benefits as traditional IRAs but are targeted to small businesses and the self-employed (these accounts are established by the employer).
- **Simplified Employee Pension (SEP)**, which function very similarly to SIMPLE IRAs but feature higher contribution limits in some cases. Unlike SIMPLE IRAs, only the employer may contribute to a SEP IRA.

\$1.2 billion – The Saver’s Credit is not a type of account but rather a tax incentive for supporting low- and moderate-income savers to make deposits into qualified DC, IRA or ABLE (Achieving a Better Life Experience) accounts. Depending on the level of annual income, low- and moderate-income single (\$19,500 - \$32,000) and joint filers (\$39,000 - \$65,000) can receive nonrefundable credits worth between 10% and 50% of their retirement plan contributions, up to a maximum of \$1,000 and \$2,000, respectively (Internal Revenue Service, [Retirement Savings Contributions](#)).

Higher Education

In 2019, the \$25 billion the federal government spent through tax programs to support higher education was allocated across the following programs:

\$17.3 billion – Tax credits and deductions for postsecondary education expenses includes the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC), that help students and families offset some of the costs associated with tuition, fees, and other course materials.

- The **AOTC** is a \$2,500 partially refundable credit (up to \$1,000)—meaning that families without tax liability can claim the credit as part of their refund—for tuition, fees, and books for degree-granting post-secondary institutions, which can be claimed for up to four years of undergraduate education.
- The **LLC** is a \$2,000 nonrefundable credit—meaning that families without tax liability cannot fully claim it as part of their refund—for tuition, fees and course materials (if they were required to be purchased directly from the school). Unlike the AOTC, the LLC can be claimed for graduate school expenses (in addition to undergraduate expenses) and is available for an unlimited number of years.

\$3 billion – Exclusion of scholarship income allows students that use academic scholarships to pay for qualified expenses—generally tuition, fees, and course materials—to reduce their tax liability by excluding those scholarship dollars from their taxable income.

\$2.2 billion – 529s and Coverdell Education Savings Accounts allow families to deposit after-tax savings—to be used to pay for qualified K-12 and higher education expenses—into a restricted savings account that grows tax free (like a Roth IRA).

\$1.9 billion – Deduction for student loan interest is a \$2,500 above the line deduction that can be claimed for loans taken out to pay for tuition and fees, course materials, room and board, and other expenses like transportation.

\$800 million – Exclusion for employer-provided education assistance, a \$5,250 exclusion for education benefits provided to employees by their employers, covering tuition, fees, and course materials.