Towards a Jubilee Economy
Session Five: Understanding Taxes
Participant's Guide

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Goals for Session Five

1. Grow in our understanding of how to participate in God's shalom and justice, by reflecting on Scripture on how a community supports the common good.
2. Grow in economic literacy by understanding the impact of taxation, intentional or unintentional, and how a community of Jesus-followers can both navigate the system and call for change.
3. Workshop someone's budget and financial goal.

Outline of Session Five

- Part 1: Reflect on Scripture about how the people of Israel contributed tithes to their common life, and also restrained their consumption on behalf of others. (30 minutes)

- Part 2: Read excerpts from Dorothy A. Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It*. Discuss our learnings as a community. Implement possible personal changes on our tax filings and tax policy advocacy. (45 minutes)

- Part 3: Personal sharing about budgeting. Help one person in the group to discuss their budget, their questions about budgeting, and the financial goal they are working towards. (15 minutes)

Session Five: Federal Taxes, Tax Equity, and Common Life

Part 1: Contributing to Common Life

We want to read and discuss a passage of Scripture which introduces us to the challenge of community and the responsibility to the poor and vulnerable.

Numbers 18:21 - 24,
Deuteronomy 14:22 - 29, 23:24 - 25, and 24:17 - 22
Matthew 19:21, 29,
New American Standard Bible

Introduction:

In past sessions, we read in *Leviticus 25* that God established the people of Israel as a renewal of Adam and Eve in the original garden land: Not in all ways, but in a big picture sense. As part of that vision, God told the Israelites to support priests ("Aaronites") and a supporting larger group of civil servants and teachers ("Levites").

Guiding Questions As You Read:

1. In Numbers 18, what value do the Levites provide the community?
2. In our society, who provides those services? How do you feel about that?
3. In the selections from Deuteronomy, how much support goes towards the poor and vulnerable? To the Levites?
4. If you had to restrain yourself from consuming as much as your land could produce, how would you feel?
5. If you had to restrain yourself from consuming as much as your income could buy, how would you feel?
6. Why did God remind the Israelites that He brought them out of Egypt?
7. In Matthew 19, Jesus calls the rich young ruler to follow him. How does Jesus' call in v.19 relate to his vision for his followers to somehow share in houses, family, and farms in v.29?

Scripture:

Numbers 18:21 - 24

[21] To the sons of Levi, behold, I have given all the tithe in Israel for an inheritance, in return for their service which they perform, the service of the tent of meeting… [24] For the tithe of the sons of Israel, which they offer as an offering to the Lord, I have given to the Levites for an inheritance; therefore I have said concerning them, 'They shall have no inheritance among the sons of Israel.'

> “The first tithe is the gift of one tenth of the remaining agricultural produce to the Levite (after removing from the produce for gift of Terumah to the priests)… The Levites, also known as the Tribe of Levi, were descendants of Levi. They were assistants to the Aaronic priests (who were the children of Aaron and, therefore, a subset of the Tribe of Levi) and did not own or inherit a territorial patrimony (Numbers 18:21-28). Their function in society was that of temple functionaries, teachers and trusted civil servants who supervised the weights and scales and witnessed agreements. The goods donated from the other Israelite tribes were their source of sustenance. They received from “all Israel” a tithe of food or livestock for support, and in turn would set aside a tenth portion of that tithe (known as the *Terumat hamaaser*) for the priests.” (Wikipedia, “First Tithe”)

Deuteronomy 14:22 - 29

[22] You shall surely tithe all the produce from what you sow, which comes out of the field every year. [23] You shall eat in the presence of the Lord your God, at the place where He chooses to establish His name, the tithe of your grain, your new wine, your oil, and the firstborn of your herd and your flock, so that you may learn to fear the Lord your God always. [24] If the distance is so great for you that you are not able to bring the tithe, since the place where the Lord your God chooses to set His name is too far away from you when the Lord your God blesses you, [25] then you shall exchange it for money, and bind the money in your hand and go to the place which the Lord your God chooses. [26] You may spend the money for whatever your heart desires: for oxen, or sheep, or wine, or strong drink, or whatever your heart desires; and there you shall eat in the presence of the Lord your God and rejoice, you and your household. [27] Also you shall not neglect the Levite who is in your town, for he has no portion or inheritance among you. [28] At the end of every third year you shall bring out all the tithe of your produce in that year, and shall deposit it in your town. [29] The Levite, because he has no portion or inheritance among you, and the alien, the orphan and the widow who are in your town, shall come and eat and be satisfied, in order that the Lord your God may bless you in all the work of your hand which you do.

> “On years one, two, four and five of the [seven year] Shemittah-cycle, God commanded the Children of Israel to take a second tithe that was to be brought to the place of the Temple (Deuteronomy 14:23). The owner of the produce was to separate and bring 1/10 of his finished produce to the Old City of Jerusalem, after separating Terumah and the first tithe, but if the family lived too far from Jerusalem, the tithe could be redeemed upon coins (Deuteronomy 14:24–25). Then, the Bible required the owner of the redeemed coins to spend the tithe “to buy whatever you like: cattle, sheep, wine or other fermented drink, or anything you wish” (Deuteronomy 14:26). Implicit in the commandment was an obligation to spend the coins on items meant for human consumption.” (Wikipedia, “Second Tithe”; see also Deut.12:11 - 18 and 26:12)

> "In years three and six of the Shemittah-cycle the Israelites set aside the (second) tithe instead as the poor tithe, and it was given to the strangers, orphans, and widows." (Wikipedia, "Poor Tithe")

Deuteronomy 23:24 - 25 and 24:17 - 22

[23:24] When you enter your neighbor's vineyard, then you may eat grapes until you are fully satisfied, but you shall not put any in your basket. [25] When you enter your neighbor's standing grain, then you may pluck the heads with your hand, but you shall not wield a sickle in your neighbor's standing grain.

[24:17] You shall not pervert the justice due an alien or an orphan, nor take a widow's garment in pledge. [18] But you shall remember that you were a slave in Egypt, and that the Lord your God redeemed you from there; therefore I am commanding you to do this thing. [19] When you reap your harvest in your field and have forgotten a sheaf in the field, you shall not go back to get it; it shall be for the alien, for the orphan, and for the widow, in order that the Lord your God may bless you in all the work of your hands. [20] When you beat your olive tree, you shall not go over the boughs again; it shall be for the alien, for the orphan, and for the widow. [21] When you gather the grapes of your vineyard, you shall not go over it again; it shall be for the alien, for the orphan, and for the widow. [22] You shall remember that you were a slave in the land of Egypt; therefore I am commanding you to do this thing.

Matthew 19:21, 29

[21] Jesus said to him [the rich young ruler], "If you wish to be complete, go and sell your possessions and give to the poor, and you will have treasure in heaven; and come, follow me… [29] And everyone who has left houses or brothers or sisters or father or mother or children or farms for my name's sake, will receive many times as much, and will inherit eternal life.

Session Five: Federal Taxes, Tax Deductions, Tax Credits

Part 2: Federal Taxes

Often, we think about taxes from the standpoint of how much we pay in taxes. Dorothy A. Brown is a professor of tax law and policy at Emory University. She gives us a big picture look at how tax burdens fall on people differently.

Guiding Questions As You Read

1. On student loan debt, compare how student loan debt is treated on taxes, compared to mortgage debt.
2. On employment wages and benefits, think about how people in your family have been impacted. Include your parents and grandparents if you can recall.
3. On intergenerational wealth, what does Dr. Dorothy Brown say about how tax policy impacts black families, generally?

Readings:

The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It
Dorothy A. Brown
New York, NY: Random House, 2021

Taxes and Student Loan Debt

As college became more accessible with the passing of the GI Bill after World War II, the tax treatment of scholarships became more important. Recall, however, that black veterans were still subject to Jim Crow laws. Those laws prevented them from taking advantage of government benefits to become homeowners. When it came to accessing benefits for college, something similar took place: Black veterans were denied entry to historically white universities and had to choose from a limited number of HBCUs, where officials at the Veterans Administration (today the Department of Veterans Affairs) often steered them towards vocational training instead of college.

In the early days of the income tax, the IRS took the position that receipt of a scholarship in exchange for education was an exchange of services, which made scholarships taxable income. Congress, however, disagreed. In 1954, the same year that *Brown v. Board of Education* was decided, it established a tax exclusion for scholarships. Those milestones, plus the creation of Pell Grants for low-income families as part of the Higher Education Act of 1965, led to significant gains in college attendance rates. The number of white men, white women, and black women attending college had nearly doubled by 1970; the number of black men tripled.

The Pell Grant program represents one of the few scholarship exclusion advantages that black students disproportionately benefit from: Pell Grants are awarded by income, and roughly 70 percent of black college students receive them compared with 34 percent of whites. In 1975, a Pell Grant covered 79 percent of the average costs of tuition, fees, room, and board at a public four-year college.

The next major shift in education tax policy took place in 1986, when the deduction for all personal interest – except mortgage interest—was repealed, and student loan interest was no longer deductible. At the same time, federal tuition subsidies were being branded as an unfair burden to taxpayers who did not attend college. The Reagan administration's Office of Management and Budget director, David Stockman, testifying before Congress in 1981, referred to federal subsidies for higher education like Pell Grants and guaranteed student loans as "entitlements that we created in the 1970s" and "excessive"; shortly after the 1986 Tax Reform Act became law, Bell Bennett, the secretary of education, wrote in a New York Times op-ed: "On average, college graduates earn $640,000 more over their lifetimes than nongraduates do. It is simply not fair to ask taxpayers, many of whom do not go to college, to pay more than their fair share of the tuition burden."

A decade later, when college costs had grown and the maximum Pell Grants were not keeping pace, two more changes took place. In 1996, 529 plans that provide favorable tax treatment for certain college savings accounts were approved by Congress. Money deposited into the account by parents or other family members is from after-tax dollars, and the investment income is not taxed as the account grows. In addition, any withdrawals for tuition, books, and room and board are treated as tax-free intrafamily gifts. To participate, of course, a family must have extra income to set aside, and as of 2012, only about 3 percent of Americans were saving for college using a tax-preferred account, according to the Government Accountability Office. Of those, 84 percent were white and 5 percent were black. A Federal Reserve study showed that the average black family's balance was $27,068 while the average white family's balance was $40,786.

A year later, Congress shifted its position again, and student loan interest became an allowable deduction. A white dental student named Jennifer Long testified before the Senate Committee on Finance, advocating for the change. She told committee members that she would owe $90,000 upon graduation, which she would pay in installments of $1,100 per month. She estimated that she would pay $7,500 in interest in her first year of repayment. (She also called out the hypocrisy of the Republicans' line of attack on student borrowers, given that the mortgage interest deduction had survived the 1986 reforms despite primarily benefiting the wealthy.)

"I could only afford to attend dental school with loans, and for many other students and parents, loans are the only way to finance their higher education," she said in her testimony. "Oddly, the Tax Code allows for individuals to deduct for a second house, but not for a first education."

Congress agreed to change the tax code, but with a catch: As it still stands today, the maximum interest deduction is $2,500, and you cannot take any deduction if your income is above $85,000 for an individual, or $170,000 for a married couple. Jennifer Long did not get the Seaborn treatment. Even if she'd met the income requirements, a tax break that capped the interest deduction at $2,500 was not going to do much good for someone like her with an annual interest payment of $7,500.

It doesn't do much good for a lot of black college graduates either. Take the research mentioned earlier in the chapter that shows black college graduates, four years out, have $53,000 in student loans, while whites have $28,000. Assume a 6 percent interest rate, a ten-year term, and income that does not disqualify you for the deduction.

With $28,000 of debt, at that rate and term, the white college graduate will pay a total of $310.86 per month. Of that, roughly $135 will be interest each month during

the first year, for a total of $1,622.67 in interest the first year. Because $1,622.67 is less than the $2,500 cap, all interest will be deducted. So in the first year, the white graduate will be eligible to deduct all of their student loan interest, and each year thereafter, the interest paid will decrease, as the principal decreases.

With $53,000 of debt, at the same rate and term, the black college graduate will pay $588.41 per month. Of that, roughly $260 will be interest each month during the first year, for a total of $3,071.48 in interest. Because the interest deduction is capped at $2,500, the black student cannot deduct the excess. Like the white graduate, the black graduate will see a decrease in the interest each year, and will eventually be able to deduct all of it when it falls under $2,500 – but they'll have to wait a while before that happens. (By my calculations, this hypothetical graduate's loan interest would be fully deductible in years 3 through 10.)

White Americans are less likely than blacks to finance their college expenses through student loans, but more likely to benefit from the student loan tax subsidy when they do. And black Americans are far more likely to finance their college education with debt, but less likely than whites to be eligible to deduct all of their interest payments on their debt – especially if they're lucky enough to get a job that pays reasonably well.

It can get even worse: If two black college graduates get married, they're statistically likely to enter the marriage with significant loan debt. As single taxpayers, they can each deduct up to $2,500 of student loan interest. But if they are married and file a joint return, the maximum amount of student loan interest they can deduct between the two of them remains $2,500. And the deduction decreases as income increases – if you earned more than $85,000 as a single person in 2020, you were ineligible. Compare this with the mortgage interest deduction, which, as we've seen, has no restrictions based on marital status or income.

There are both historical and contemporary reasons that black student loan debt remains a drag on wealth building, but hidden in plain sight is a tax system that rewards those who can pay for college outright, and those people are mostly white. This results in black families carrying more student debt than their white peers, which, as we saw when comparing the debt loads and interest payments of the average black graduate and average white graduate, has a snowball effect on the black-white wealth gap. And that example was the best-case scenario, in which a black graduate's principal and interest are reduced over time. If a graduate is limited to income-based repayment or defers, the interest accumulates and is added to the principal, making repayment even more out of reach. Dr. Jason Houle, associate professor of sociology at Dartmouth College (along with his co-author, Dr. Addo), researched student debt and race and found that student loan debt accounts for "about 10 percent" of the racial wealth gap when a college graduate is twenty-five years old; by age thirty or thirty-five, it explains 25 percent of the wealth gap.[1]

Taxes on Wages, Benefits

Wage discrimination was explicit and legal in the early twentieth century. The Fair Labor Standards Act of 1938 (FLSA), which included minimum-wage provisions, excluded farm laborers and domestic workers specifically because those were majority-black occupations – according to the 1930 census, 65 percent of all black

[1] Dorothy A. Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It* (New York, NY: Random House, 2021), p.120 – 125.

workers were in one of the two fields. Several members of Congress objected to creating equal wage standards for black and white workers as the bill was being debated, but Florida congressman James Mark Wilcox's explanation was most plain: "There has always been a difference in the wage scale of white and colored labor.... We may rest assured, therefore, that when we turn over to a federal bureau or board the power to fix wages, it will prescribe the same wage for the Negro that it prescribes for the white man. Now, such a plan might work in some sections of the United States but those of us who know the true situation know that it just will not work in the South. You cannot put the Negro and the white man on the same basis and get away with it."

The lack of wage protections meant that black workers were simply not considered when retirement plans became more common among American workers during World War II. Those retirement plans had become tied to employment as "an unintended byproduct of its wartime efforts to standardize tax policies and regulate wages," writes the sociologist Beth Stevens. In 1942, two acts of Congress – the Revenue Act and the Stabilization Act – incentivized employers to create pensions and offer other benefits. Pensions, which are typically sponsored by an employer or union, allow both workers and companies to set a portion of their earnings into a retirement account. Workers avoid paying taxes on the contribution, or on any interest earned on the account, which is typically invested. There are two different types of employment-based retirement accounts: defined benefit plans and defined contribution plans. Defined benefit plans, more commonly referred to as pensions, are generally found in union-represented workplaces. A defined benefit plan guarantees a payout at retirement, regardless of how much is invested. It's low-risk for employees and puts the burden of the payout on the employer – which is why employers don't like them, and in recent decades have shifted towards defined contribution plans like 401(k) accounts, which are now the most common kind of employment-based retirement plan, depend on worker contributions, sometimes with employer-matched funds. They also don't guarantee income; if, at retirement, a worker's account balance is $1,000, that's the sum total of the worker's retirement benefit. In both cases, any money set aside by the employer to provide that payout is treated as tax-free to the employee, though the employee does pay taxes on money when it is withdrawn at retirement or when the retiree turns seventy-two.

Retirement accounts allow people to have income once they stop working – without them, many more Americans would spend their final decades in poverty – but don't think they were created out of care and concern for older workers. The Revenue Act of 1942 incentivized companies to create pensions by levying a huge tax (between 80 percent and 90 percent) on excess profits – defined as corporate profits that were greater than they'd been prior to the war. Companies could avoid the tax by placing some profits into pension trusts, and then deducting those amounts from their overall profits.

At the same time, Congress enacted the Stabilization Act of 1942, which created wage controls limiting raises, but excluded benefits such as health insurance and pensions from those controls. The Revenue Act forced employers to find new ways to compete for the best workers (who in their minds were white), and tax-free benefits were a way to attract them. Two key provisions of the Revenue Act led more employers to provide more benefits: One required pension plans to cover at least 70 percent of employees in order for the employer to receive tax breaks; and a second stated that the

calculation of benefits could not be skewed in favor of high-income workers. Employers can't, for example, agree to a 1 percent 401(k) contribution for wages up to $50,000 and then an additional 15 percent contribution for the excess over $50,000, because it would benefit higher-compensated employees. So as the percentage of Americans subject to tax increased, these tax-free benefits moved down the income scale from higher-income to lower- and middle-class white working taxpayers. Between 1941 and 1945, contributions to pension trusts went from $171 million to $857 million, and by the end of World War II, health insurance coverage tripled and pension coverage increased by a third.

Black workers, however, simply weren't part of the new wave of employment incentives and protections. By deliberately leaving majority-black occupations out of the Fair Labor Standards Act, Congress ensured that black workers would have to work for whatever wages an employer wanted to provide – and forget about raises or pensions. Employers were permitted to pay black workers less, keep them out of jobs that could be filled by white workers, and exclude them from insurance and benefit plans, all with the legal backing of the federal government.

Take my father, for example: Daddy was a plumber who worked for many years for a small private company. Though his boss, Mr. Gelman, was very generous (you may recall he helped my parents buy their house), like most small employers he did not offer health insurance or a retirement plan. For years, my parents worked and raised a family paying for our healthcare with after-tax dollars, and like Racheal, we were very lucky to avoid serious illness. My parents couldn't afford to pay for dentist visits for all four of us, so Miss Dottie took only me and my sister.

There were better jobs out there for a skilled plumber, and the best of them were in the public sector, which offered tax-free health insurance and a defined benefit plan. From 1950 to 1970 the proportion of the workforce with some type of health insurance through their jobs went from roughly 50 percent to 80 percent. Almost 50 percent of workers in the private sector had retirement plans, more than twice the percentage in 1950. But my father was not one of those employees.

To get a job in the coveted public sector, you had to belong to the union. In fact, the existence of the union was part of the reason the job was so coveted; the expansion in benefits like pension and health insurance in the postwar years was due in large part to collective bargaining. But the union was famous for creating obstacles that prevented nonwhite workers from joining. In 1964, there were only sixteen black plumbers in the union, out of a total of 4,100. When the city forced a contractor to hire four nonwhite plumbers on a huge project in the Bronx that year, the union plumbers walked off the job.

When the Civil Rights Act was passed later that year, the unions were forced to integrate, and in the mid-1970s my father got a job with the New York City Housing Authority. My father died in 1994, and the pension he earned, thanks to the union, continues to support my mother. But he worked for twenty years before he had access to the same wealth-building benefits as the city's white plumbers.

Thanks to the Civil Rights Act, today's employers aren't permitted to openly offer higher wages and better benefits plans to white employees. But the explicit discrimination of the FLSA laid the groundwork for the implicit discrimination that is alive and well in the labor market today, excluding black Americans from jobs that offer health insurance and retirement accounts. If we think of retirement accounts as a

pyramid (the way we did with higher education), then the best, those at the top, are defined benefit plans, followed by employer-matching defined contribution accounts. At the bottom are IRAs: They're available to anyone with earned income, but employees are responsible for funding them and paying any fees associated with them. Over the last few decades, the percentage of employees covered by defined contribution as opposed to defined benefit plans has significantly increased – from 41 percent in 1985 to 61.3 percent in 2010, according to my research.

When it comes to who gets what kind of retirement account, the racial divide is stark. The Bureau of Labor Statistics classifies jobs outside of services, sales, transportation, and construction as "professional and related occupations"; this broad category includes everything from architect to zoologist, but what these jobs have in common is that they're the most likely to come with tax-free perks. Almost two-thirds (66.4 percent) of employers in those professional industries sponsor retirement accounts, and their workforce is 80 percent white and 9.4 percent black.

In contrast, in the service occupations, which includes custodians or restaurant staff, and where retirement sponsorship rates are only around 34 percent, black Americans make up 16.8 percent of the workforce. If we narrow the focus, black overrepresentation and white underrepresentation increase. Dr. Tatjana Meschede, associate director of the IASP and senior scientist at the Heller School for Social Policy and Management, described in her co-authored research: "Historical legacy and contemporary employment practices concentrate Black and Latino working people disproportionately in jobs and industries stripped of or lacking in benefits that connect work to wealth and better livelihoods."

The healthcare industry, for example, is one of the fastest growing fields in the country today, projected to add about 1.9 million new jobs by 2028. The median annual wage for practitioners and technical employees (such as doctors, nurses, and dental hygienists) is more than one and a half times higher than the median wage for all occupations, but the median annual wage for workers in health support fields, like health aides and assistants, is below that median.

Guess which are the "white" jobs and which are the "black" jobs – the ones where the pay is better or worse than the median?

Meschede and her colleagues found that while black workers made up 16 percent of the healthcare labor force, they are more than three times as likely to work as lower-paid health aides than their white counterparts. And even when black and white healthcare workers earned comparable salaries, there were huge discrepancies in their overall wealth, which Meschede's report attributes to the lack of access to "asset-building benefits" – the health insurance and retirement benefits that make up one-third of total employee compensation. Black health aides earning $23,100 in income had median wealth of $900; white health aides earning $23,600 had median wealth of $5,300. Among registered nurses, black and white nurses reporting comparable incomes near $55,000 reported median wealth of $20,000 and $93,500, respectively.

A common argument, when it comes to both care and compensation in the health field, focuses on education and training. It's true that home health aides and anesthesiologists don't require the same levels of training and certification to do their jobs, and becoming a physician requires significant financial investment. However, the healthcare field isn't an outlier when it comes to these racial wealth discrepancies; it's

the standard. Meschede and her colleagues found that the discrepancies exist across industries, regardless of education or specialization, including in highly paid fields like technology and finance. Not only were blacks and Latinos underrepresented in STEM fields, Meschede found, "for Black employees, pay is also significantly lower than Whites in finance and STEM with the same degrees. While incomes increase for all in more highly compensated sectors, the gains from entering a higher-paying field are not shared equally.

And it's important to remember that income is not the same as wealth, and increases in income alone will not compensate for lack of benefits. Researchers found that median wealth would go up substantially for black workers in all fields if they had equal coverage rates for employer-based healthcare and pensions: a 25 percent increase if health access were equalized, and a 53 percent increase if pension rates were equalized.

Unfortunately, in the twenty-first century economy, the wealth building associated with benefits is even less accessible than it used to be. Increasingly, corporations avoid hiring full-time direct workers, and instead hire long- or short-term subcontractors. It's a win for the corporation, which gets the labor without having to provide the guaranteed salary or benefits that full-time employees receive. However, the practice is creating a new form of occupational segregation, where white workers are more likely to have direct jobs, and nonwhite workers are more likely to have contract jobs. A 2016 report on subcontracting and diversity in Silicon Valley revealed that while black and Latino workers made up 10 percent of direct-hire employees, they constituted 26 percent of white-collar contract hires and 58 percent of blue-collar contract hires. "Contract workers often do not have access to the generous health, parental leave, child care, employee shuttles, and other benefits than tech companies offer their core employees," the report noted.

They also miss out on bonuses like profit sharing – a policy that Atlanta-based Delta Air Lines Inc. has used as a big public relations boost. In February 2020, the airline announced a $1.6 billion profit-sharing bonus of roughly two months' pay for its employees. "For years, I would get beaten up by Wall Street," CEO Ed Bastian said at an event at the Cobb Chamber of Commerce in Atlanta. "They thought the profits were theirs, and 'Why are you giving the profits away to the employees?' Wall Street has actually come full circle, and they realize that Delta is the most awarded airline in the world because of its employees.

However, Bastian didn't mention the ninety thousand contract workers – who push Delta passengers in wheelchairs, operate Delta connection regional flights, and at some airports check in customers and handle their baggage – who, because they were not direct employees, didn't get a share of the profits.[2]

Taxes and Intergenerational Wealth

The tax code rewards and encourages generational wealth building in two major ways. The first is the preferential tax treatment that comes with asset ownership. The second is the provision for tax-free financial transfers to family members, both while the giver is alive and after they die, as part of their estate. In both cases, reduced or eliminated taxes result in increased savings and investment opportunities for the next

[2] Dorothy A. Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It* (New York, NY: Random House, 2021), p.135 – 144.

generation. Each one dates back to the beginnings of our "progressive" tax system, and like many of the other shifts we've seen, each one has been influenced by the interests of the wealthy, white, and powerful.

Stock investments outside of a retirement account – referred to as "capital assets" – receive very different treatment. If you buy stock and then sell it for a loss, you can take a tax deduction, which can be used to offset other gains or income. If you sell stock at a gain, you pay taxes on the income – but at the capital gains rate, which is different, and significantly lower, than the one that applies to wage income. (While the tax treatment for bonds is more complicated today, there are also significant tax subsidies associated with bond ownership. For example, state and local bonds pay interest that is often received tax-free by the owner.)

The tax rate that applies to gains from stock and the sale of other capital assets, such as a home, is called the preferential rate. This rate varies depending on a taxpayer's total income and how long they have held the stock, but it's always better than the progressive rate, which applies to wage income: The maximum preferential tax rate is 20 percent, while the maximum progressive rate is 37 percent. This means that taxpayers will pay a significantly lower tax rate on income from stock than they will on their wage income. (Remember, in chapter 2, our discussion of the tax breaks that come with selling your home? That's the preferential rate in practice, too – up to $500,000 of the gain tax-free, if you are married, and the remaining amount taxed at the preferential, not progressive, rate.)

To qualify for the preferential rate, an asset must be held for more than one year before it is sold. (Gain from sale of stock held less than one year is taxed the same way as wage income.) After that, the greater the taxpayer's share of capital gains subject to the preferential rate, the lower their overall effective tax rate will be. The preferential rate can be 0, 15, or 20 percent, depending on the taxpayer's total income (including any capital gains) and their filing status. If the taxpayer's total income is more than $441,450, they will pay the maximum rate of 20 percent – which, you'll recall, is still 17 percentage points less than they'd pay if taxed according to the progressive rate system. A taxpayer whose only income is from capital assets of $50,000 will pay a preferential rate of 15 percent if single, and zero percent if married or filing as head of household. (That's another built-in marriage bonus.)

Let's compare two single taxpayers with $150,000 in taxable income (after all deductions) in 2020: Melissa and Michele. Melissa's $150,000 is all from her salary; Michele's is $100,000 from salary and $50,000 from the sale of stock. Melissa will pay $30,079.50 in taxes while Michele pays only $25,579.50. Why does Michele save $4,500 on her tax bill compared with Melissa? Because all of Melissa's income is subject to the progressive tax system, compared with only two-thirds of Michele's. Michele's salary income is taxed at the same rate as Melissa's, but her stock income receives the lower 15 percent preferential rate, while Melissa's last $50,000 of income is taxed at her highest progressive rate of 24 percent. This is why billionaire Warren Buffett's effective tax rate is lower than his secretary's: Most of his income comes from stock ownership and is subject to the preferential rate, while most of hers comes from wages and is subject to the progressive tax rate.

How did this happen, when the purpose of the progressive tax system is to ensure higher-income taxpayers pay higher tax rates? Just like the marriage bonus, the preferential rate was created through pressure from the wealthiest white taxpayers in

the early days of our taxation system. In 1916, when capital gains were taxed the same as ordinary income, only the richest 1 percent of Americans filed a tax return. Among them was Frederick F. Brewster, who (wait for it) was paying taxes on income from his enormous wealth, didn't like it, and decided to sue so he ultimately wouldn't have to.

Frederick's father, Benjamin, was a business associate of the Rockefellers and earned his fortune in oil and railroads; for many decades he was considered the second-wealthiest man in America, right behind his colleague, John D. Rockefeller, Sr. When Benjamin died in 1897, Frederick, then around twenty-five, inherited a quarter of his father's fortune. He went on to become a director of the New York, New Haven, and Hartford Railroad Company and build a twenty-five-acre estate in Connecticut for his bride, Margaret. The New York Times described him as "a wealthy young man in this city who is understood to have large interests in the Standard Oil Company."

In 1916, Frederick sold more than $400,000 in bonds and did not include the profits – approximately $84,000 – on his tax return, arguing to the Bureau of Internal Revenue (known today as the IRS) that because he did not regularly make such sales, the profits didn't count as income and weren't subject to taxation. The bureau disagreed and said he owed $17,756.79 in additional taxes. (In today's dollars, that's about $10 million in bonds sold, $2 million in profit, and a tax dispute of $400,000. The Brewsters make the Seaborns, our other wealthy white tax litigants from chapter 1, look like paupers.) Brewster won the suit in district court, but the IRS appealed, and the case went to the Supreme Court in 1921.

The Supreme Court determined that income from the sale of property was required to be included in taxable income and reversed the lower court's decision. But Brewster's defeat led to a major victory in Congress for the wealthy 1 percenters who occasionally sold stocks, bonds, and real estate. Congress responded to the Supreme Court decision by enacting that same year a lower tax rate for this type of property. At the time, the highest marginal income tax rate was 73 percent; the new capital gains rate was set at 12.5 percent.

By creating the lower capital gains rate, Congress found a way to discourage the richest Americans from using tax avoidance strategies, but kept them from protesting the change by offering them special treatment. Only eight years into the progressive tax system, a huge loophole was created for the wealthy; the richest Americans would not even pay the progressive tax rate on a portion of their income. The effect has only grown over time; when the highest-income households didn't get any marriage-penalty relief in 2017, perhaps the reason they didn't protest was that the majority of their income was already subject to the low preferential rate, making a shift in the progressive system irrelevant for them. In 2019, roughly 85 percent of income subject to the low preferential rate went to the richest 5 percent of taxpayers, according to the Tax Policy Center, and almost 75 percent went to the top 1 percenters; this is how white wealth increases across a century.[3]

[...]

Researchers have found that "financial transfers to parents (much more common among Black college-educated households) significantly decrease household net wealth by more than 25 percent.

[3] Dorothy A. Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It* (New York, NY: Random House, 2021), p.169 - 174.

White households, in contrast, are four and a half times more likely than their black peers to receive a gift or an inheritance. A study that tracked black and white families over twenty-seven years, from 1984 to 2011, showed that almost half (46 percent) of white households received some type of financial transfer, while only one in ten black households did. All the households receiving family financial resources built more wealth over the period studied; however, the white households experienced growth at a far higher rate than their black counterparts. The white Americans who received a financial transfer – 46 percent of the white Americans in the study – received a median of $83,692. But what's perhaps even more astonishing is that, for these families, wealth grew to $282,000 – more than three times the amount of the gift they'd received.

Take one middle-class white family from the study: Jessica and Nicole Bzdell, urban homeowners who held nonprofit jobs and had a combined household income of $80,000. They borrowed money from Nicole's mother for a new rural home; then, when Nicole's mother passed away, Nicole inherited about $1 million in stocks and at least $300,000 in cash. When their urban home sold, they received $200,000 more – likely tax-free. Jessica and Nicole had very little taxable income from wages, greater preferential income from capital gains likely subject to a 0 percent tax rate (because of their low taxable income), and of course a tax-free inheritance of more than $1 million. "This inheritance shifted the family into the top decile of wealth holdings in the U.S.," the study's authors noted. "Jessica and Nicole inherited Nicole's mother's wealth status, moving them beyond their own achievements in work and education."

In contrast, over the twenty-seven-year period of the study, only 10 percent of black Americans received a financial transfer, with a lower median value of $52,240. Those families saw their wealth grow by only $20,000 – more than the black families who didn't receive transfers at all, but still less than the white families who didn't receive transfers either. For white households, median wealth growth for those with and without financial transfers was $282,000 versus $72,000; for black households, the median wealth growth for those with and without financial transfers was $20,000 versus $12,000. Where white families saw their wealth tripled, black families saw it drained. The study concluded that financial transfers did not create wealth for black Americans the way they did for white Americans, and this difference was a significant contributor to the racial wealth gap.

How does that happen? It's a question of whether the financial transfer goes towards a wealth-building activity, like a college tuition or a down payment on a home, or toward a basic need or an emergency. And black families are far more likely than white families to be making financial transfers that are used to help family members cover daily expenses – like Racheal's mother paying for her to go to the dentist as a Christmas gift. Earning a higher income does not protect black families from such wealth depletion; in fact, it makes them more vulnerable. "As income increases, blacks are increasingly more likely than whites to report having provided financial assistance to friends and family," one study found. "Middle-income blacks are significantly more likely than middle-income whites to report having provided informal financial assistance in the past year."

That conclusion was consistent with earlier research showing "the middle-class black families in [the study] suffered about a 27 percent reduction in their wealth relative to white families as a result of the kin networks into which they were born."[4]

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[4] Dorothy A. Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans and How We Can Fix It* (New York, NY: Random House, 2021), p.183 - 185.