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How the Inflation Reduction Act's Tax Reforms Can Help Close the Racial Wealth Gap

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Last month, President Biden signed into law one of the most transformative and progressive tax law packages in decades. The Inflation Reduction Act (IRA) created a new minimum tax on the largest corporations to ensure they pay taxes on the profits they report to shareholders, established a new tax on stock buybacks to prevent corporate profits from going untaxed and provided the Internal Revenue Service (IRS) with financial resources to crack down on tax evasion by wealthy corporations and households.[1]

The tax justice victories in the IRA are also victories for racial justice. While much attention has focused on the equity impacts of the bill's health and climate provisions,[2] the corporate tax reforms will help narrow the racial wealth gap. Ballooning corporate equity values have been a powerful driver widening the racial wealth gap in recent years. To the extent that those values have been inflated partly through tax avoidance that pads corporate profits, the IRA's measures to crack down on that avoidance will help advance racial equity.

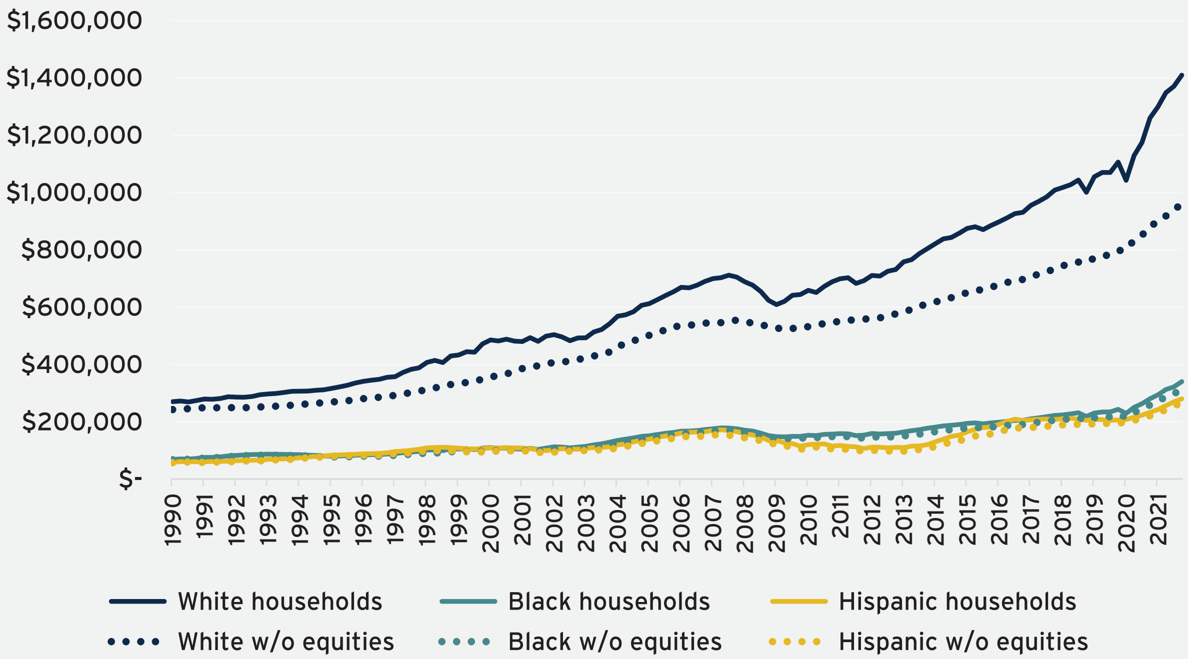
Centuries of discrimination have prevented people of color from building wealth, leaving them economically disadvantaged compared to their white peers.[3] Taxes have played a role in creating and sustaining it, and they can also play a role in narrowing that gap.

Corporate Equities Are Widening Racial Wealth Gaps

Over the past three decades, the racial wealth gap has widened, driven by growing corporate equity value held in stocks and mutual funds. While fairness and justice concerns are paramount, the detriments of the racial wealth gap are broader reaching. Researchers have shown that this problem stunts the growth of our economy.[4]

In 1990, the average net worth of white households was 3.9 times that of Black households and 4.5 times that of Hispanic households. By 2022, those gaps had grown to 4.1 and 5.0, respectively. However, if corporate equities were not included, the gap between white and Black households would have shrunk over the same time from 3.6 to 3.0, and between white and Hispanic households it would have shrunk from 4.2 to 3.6.

FIGURE 1. Wealth Begets Wealth: White Household Net Worth Exceeds and Grows Faster Than Black and Hispanic Household Wealth

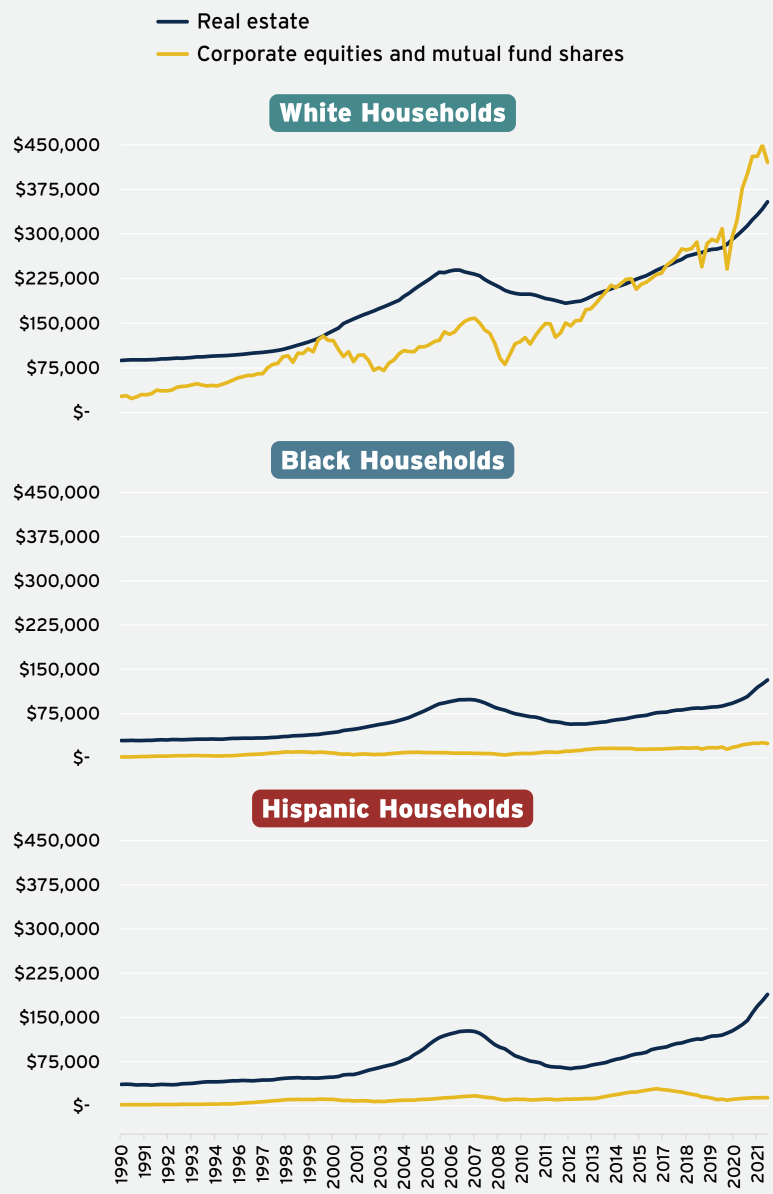


Source ITEP analysis of Federal Reserve Distributional Financial Accounts

This growth in the racial wealth gap is likely driven by the households at the very top. This is suggested by a recent Treasury Department analysis, which looked at the same racial wealth gaps but examined median, rather than mean (average) wealth.[5] Because the median wealth for each group is simply the wealth of the family at the mid-point of the distribution (meaning half the families in the group have more wealth and half have less wealth), the median is less distorted by extreme wealth of those at the very top. Whereas we find the mean racial wealth gaps to grow slightly over the past 30 years, Treasury finds that median racial wealth gaps are mostly unchanged over that period. (Treasury did, however, note the wealth gap according to its measure is substantial and seems unlikely to ever disappear without new policies.)

For most families of all races and ethnicities across this period, the largest sources of net worth were their homes and other real estate. However, in recent years, stock ownership has grown to be the largest source for white families (particularly wealthy white families), surpassing both real estate and private business ownership. For Black and Hispanic families, the value of stock ownership has remained well below real estate and at similar levels to private business ownership. For most families, corporate equities are something they can afford to invest in only after they have covered the basics like shelter. Beyond this, many people of color who might have the resources to invest in financial markets have been left out due to historical discrimination in the hiring and marketing practices of investment firms.[6] Added to that are centuries of racism and false promises of secure wealth building opportunities that have created a mistrust of the stock market.[7]

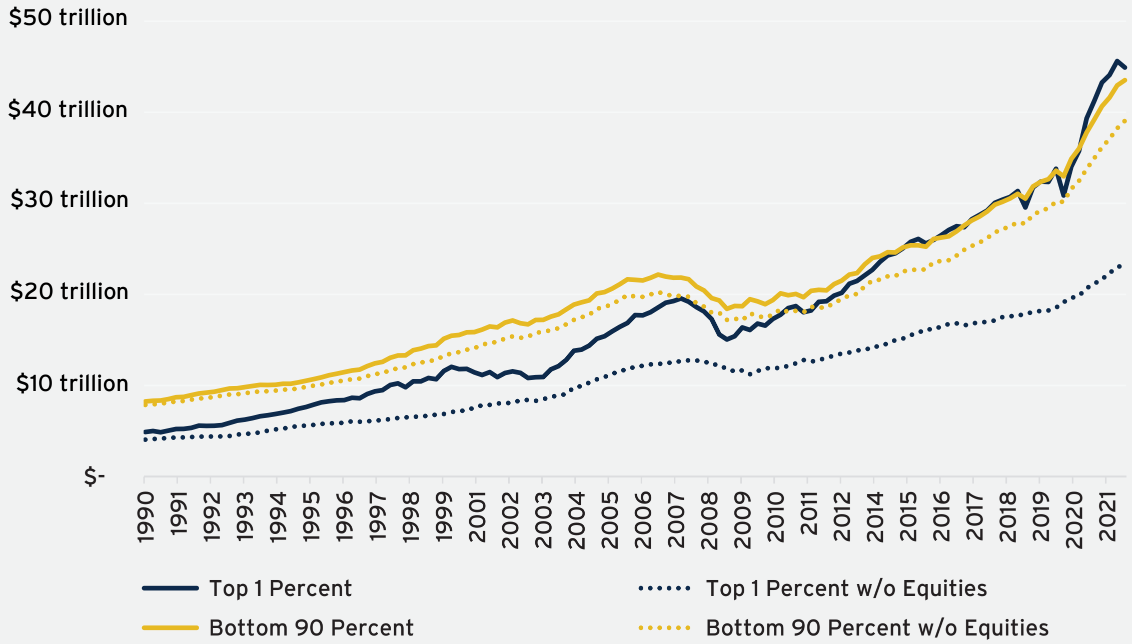
FIGURE 2. Corporate Equities are Largest Source of Net Worth for White Families, Real Estate Remains On Top for Black and Hispanic Families



Source ITEP analysis of Federal Reserve Distributional Financial Accounts

The surge of corporate equity ownership over real estate and other capital assets for white households is concentrated in the wealthiest families. Prior to 2015, the total combined wealth of the top 1 percent was less than that of the bottom 90 percent. That should be a low bar to clear, but beginning in 2015, the wealth of the very richest surpassed that of the bottom 90 percent of the country's households. Today, 1 percent of the country has more wealth than the bottom 90 percent combined. This is yet another pernicious trend in inequality driven by ballooning corporate equity values. Without equities, the wealth of the top 1 percent would be closer to half that of the bottom 90 percent.

FIGURE 3. **Corporate Equities Pushed Wealth of Top 1 Percent Above Bottom 90 Percent**



Source ITEP analysis of Federal Reserve Distributional Financial Accounts

New Corporate Tax Provisions Will Combat the Widening Racial Wealth Gap

While the IRA does not include any direct wealth taxes, it does include two taxes that will ensure the very largest corporations are paying some taxes. These provisions will not eliminate the racial wealth gap but will help shrink it. And critically, they mark a turning point away from decades of tax policies that have given increasingly more advantages to the disproportionately wealthy, white owners of those corporations.[8]

The new corporate minimum tax on "book" profits ensures that the largest corporations pay a tax rate of at least 15 percent on the profits that they report to shareholders. Corporations often report much larger profits to their investors than they report to the IRS, allowing them to lure new investors by appearing highly profitable while also allowing them to pay as little corporate income tax as possible. The new tax would require corporations making $1 billion or more in worldwide profits to pay a 15 percent rate on the profits they report to shareholders. The corporate minimum tax will raise $223 billion over the next decade.

Another provision applies a 1 percent excise tax to corporations that use stock buybacks to shift their profits to executives and investors. Stock buybacks, like dividends, are a way for corporations to distribute some of their cash to shareholders when they decide there are no desirable investments within the business. Dividends are taxed in the year they are issued under current law, normally at a rate of 20 percent, but stock buybacks work differently. When a company buys shares of its own stock off the market, the value of the stock rises for the remaining shareholders, resulting in capital gains. The executives and investors who benefit from this increase in value do not owe any taxes until they sell their shares, and if they pass their holdings to their heirs, then no taxes are owed by either the estate or the heirs.

This new excise tax is expected to raise $74 billion over the next decade while reducing the tax advantage that buybacks have over dividends. By raising the cost for companies to shift profits to their shareholders, the tax favors workers and factories over shareholders, who are predominantly white executives and investors.

While centuries of tax policies have benefited corporations and the ultrawealthy, programs that improve the economic outcomes of people of color – whose communities have been systematically subjugated since the founding of this country – have been chronically underfunded. Funds from these new corporate tax provisions will be reinvested in programs that lower the cost of health care and build a green energy economy—with particular focus on measures to support underserved communities that will undoubtedly help Black and Latino households.[9]

Funding for Tax Enforcement Might Also Help Close the Racial Wealth Gap

In addition to the increased taxes laid out above, the IRA will also increase revenue due to the funding boost for tax enforcement. The law provides $80 billion in new funding for the IRS over the next decade, an investment that will more than pay for itself.

Increased tax enforcement on big corporations and people making more than $400,000 a year will save the government $200 to $400 billion in lost revenue. This is tax revenue that is legally owed but that—due to a decade of underfunding[10]—the IRS has not had the capacity to collect. The agency currently has fewer agents able to assist law-abiding taxpayers—and conduct examinations of wealthy people trying to cheat the system—than at any point since World War II.[11]

Reversing this underfunding will provide the IRS with the tools to focus more on the complex tax maneuvering of corporations and the ultrawealthy. As the agency's staff has declined and its technology has aged, audits of big businesses and their very rich shareholders have dwindled. A recent study from Syracuse University found that to keep costs down the IRS has audited low-income people, who are disproportionately people of color, at a higher rate than wealthier, white people.[12] The IRS Commissioner has taken issue with this study[13], but data from the Treasury Department clearly show that audit rates have been declining much more precipitously for millionaires and big corporations than for the lowest wage earners.[14]

By focusing the agency's resources on ensuring profitable corporations and wealthy families pay the taxes they owe, this provision will help to chip away at the racial wealth gap. Companies and the wealthy, like ordinary people, should have to pay their taxes. Enhanced tax enforcement will offer an important source of revenue for the government to invest in health and climate programs that will move our country in a healthier and more racially equitable direction.

Lawmakers Should Build on This Success and Enact More Progressive Tax Policies

The Inflation Reduction Act raises revenue through more robust taxation of corporate income that disproportionately flows to wealthy, white households and reinvests the funds in ways that partly support communities most susceptible to unemployment and the detriments of fossil fuel extraction and energy production. There are many additional ways that Congress could build on this progress, by better taxing wealth or income from wealth and by eliminating corporate loopholes that remain part of the tax code.

The IRA is a great step forward for the country, putting into place remedies that are needed to overcome past historical injustices. It will start to close the racial wealth gap and improve the lives of people of color who have been chronically pushed aside in the American economy. The spending in IRA is well-directed given the climate and health crises the country faces. Additional spending priorities, some of which passed the House last year, would also build on this foundation in important ways that are crucial to reducing racial disparities.

Congress should also take the next step to make our tax code more racially equitable by extending the 2021 Child Tax Credit (CTC) expansion. This one-year expansion helped millions of people take care of their families, boosted incomes and dramatically reduced poverty.[15] It helped children of all races and across middle and low-income families, while being particularly helpful to families who struggle economically. Reinstating the 2021 expansion would help millions of families across the country and help advance racial equity in ways that other CTC expansion plans, like the one proposed by Sen. Mitt Romney, would not.[16]

This country, and people of color in particular, have been waiting a long time for these positive changes, and while we celebrate this moment, we cannot forget that there is more work to do. Lawmakers have many opportunities to pass reforms that will make our tax code fairer and further reduce racial inequity in our economy.[17] The IRA is a great step forward; better taxing wealth and income from wealth and expanding targeted refundable tax credits would build on this progress.

ENDNOTES

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15. Joe Hughes, ITEP, “Census Data Shows Need to Make 2021 Child Tax Credit Expansion Permanent,” September 14, 2022. **https://itep.org/census-data-shows-need-to-make-2021-child-tax-credit-expansion-permanent/**

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