



California Budget
& Policy Center

5 Facts

Promoting Racial Equity Through California's Tax and Revenue Policies

APRIL 2021 | BY KAYLA KITSON

Legacies of historical racist policies and ongoing discrimination in areas such as education, employment, and housing have barred many Californians of color from economic opportunities. As a result, Californians of color — particularly Black, Latinx, and American Indian Californians — are less likely to have high incomes and to have built enough wealth to be able to weather periods of income loss, retire comfortably, and pass on wealth to their children. These barriers have also made Californians of color more likely to have experienced health and economic consequences of the COVID-19 crisis. One area policymakers should consider in efforts to address

these inequities is the state's tax and revenue policies. Although these policies may appear race-neutral, they can play a significant role in either worsening existing racial and ethnic income and wealth disparities or promoting greater equity for Californians. A policy need not be explicitly racist in order to have racially inequitable outcomes.¹ Because many current state tax policies privilege Californians with higher incomes and wealth, they widen existing racial inequities. Policymakers can also use tax policy as a tool to promote racial equity, both by making the tax code itself more equitable, and by raising revenue to invest in the social and economic well-being of Californians of color.

5 Facts

- 1** Legacies of Racist Policies Have Led to Significant Racial Income and Wealth Inequality in California
- 2** Many Tax Breaks Benefit People with Higher Incomes, Worsening Racial Inequities
- 3** Costly Tax Breaks for Homeowners Are Less Likely to Benefit Californians of Color
- 4** Refundable Tax Credits Increase Racial Equity by Boosting Incomes for Low-Income Californians of Color
- 5** Taxing Wealth and High Incomes Would Reduce Racial Inequity and Raise Revenue to Help More Californians Thrive

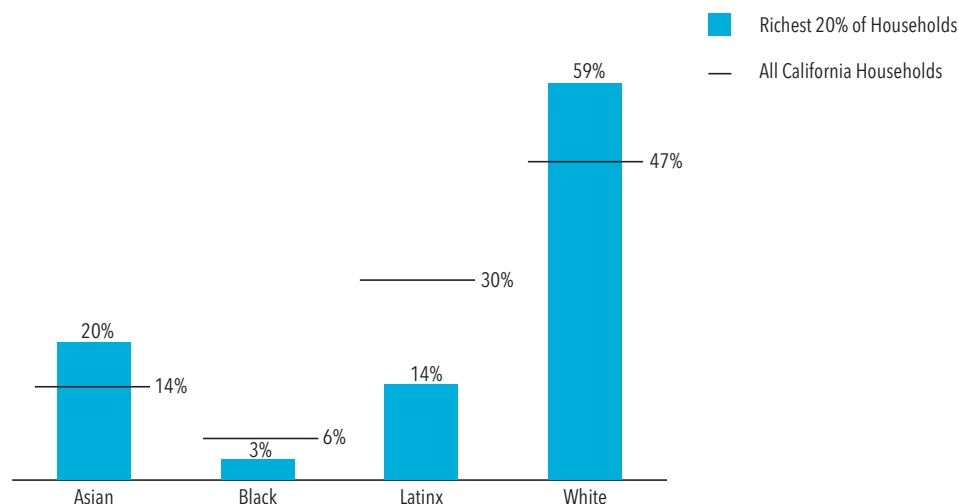
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Legacies of Racist Policies Have Led to Significant Racial Income and Wealth Inequality in California

Centuries of racist policies, from enslavement, land theft, and genocide to educational and residential segregation, inadequate employment antidiscrimination laws, overpolicing and overincarceration of communities of color, and other forms of ongoing discrimination have locked many people of color out of opportunities to build income and wealth.² As a result, American Indian, Black, Latinx, and Pacific Islander Californians are less likely to have high incomes than white and Asian households.³ For example, Black households represent only 3% of the richest one-fifth of California households, even though they make up 6% of all California households.⁴ Latinx households represent 14% of the richest fifth compared to 30% of all households. And while American Indian and Pacific Islanders make up very small shares of California households, they represent even smaller shares of the richest 20%.⁵ There are also stark differences in wealth — assets minus debts — between racial and ethnic groups. The median wealth of Black and Latinx families in the United States in 2019 was \$24,100 and \$36,100, respectively, compared to \$188,200 for white families.⁶ This racial wealth gap leaves Black and Latinx families at a significant disadvantage in their ability to weather crises like the current COVID-19 pandemic and recession, to save for retirement, and to pass wealth on to their children.

Black and Latinx Californians Are Underrepresented Among Californians with High Incomes

Percentage of California Households, 2017 - 2019



Notes: Racial and ethnic categories are mutually exclusive, and reflect the race or ethnicity of the head of household. American Indian and Pacific Islander households are also underrepresented in the richest 20% of households, but are not shown here because they each represent less than 0.5% of all California households. Income data do not include capital gains.

Source: Budget Center analysis of US Census Bureau, American Community Survey data via IPUMS USA

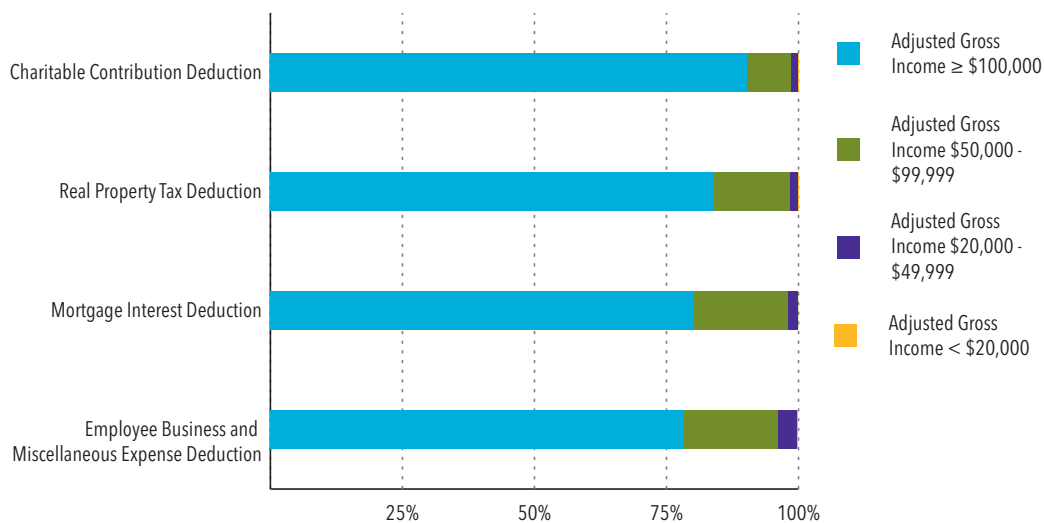
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Many Tax Breaks Benefit People with Higher Incomes, Worsening Racial Inequities

California is expected to lose over \$60 billion in state revenues in 2021-22 to personal income tax breaks, some of the largest of which provide the majority of benefits to high-income families.⁷ For this reason, many tax breaks disproportionately benefit white and Asian Californians and provide little to no benefits to many other Californians of color. For example, many tax benefits are only available to those who opt to “itemize” their tax deductions, and people who itemize tend to have higher incomes. California’s four largest personal income tax deductions provide more than three-quarters of their benefits to families with incomes over \$100,000, who are generally the richest 20% of families, while providing nearly no benefits to those with incomes below \$20,000.⁸ American Indian, Black, and Latinx Californians are more likely to have low incomes, so they are less likely to benefit from these tax breaks.

California’s Four Largest Personal Income Tax Deductions Mostly Benefit High-Income Californians

Percentage of Tax Benefits Received by Adjusted Gross Income Group, 2017

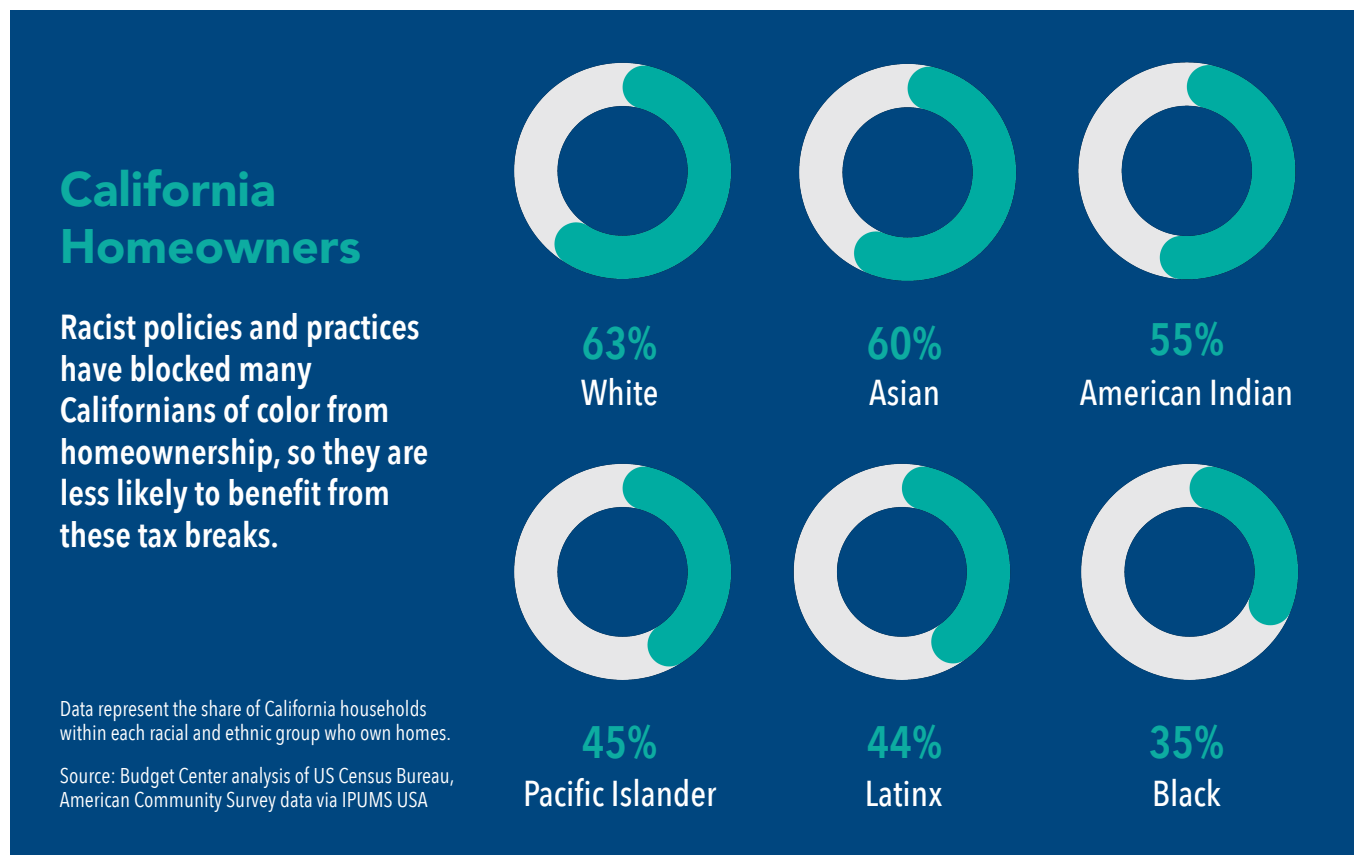


Source: Budget Center analysis of Franchise Tax Board data

3

Costly Tax Breaks for Homeowners Are Less Likely to Benefit Californians of Color

California provides several tax benefits for homeowners, including the deductions for mortgage interest and property taxes, which are respectively projected to cost the state \$4.1 billion and \$3 billion in 2021-22. Racist policies and practices have blocked many Californians of color from homeownership, so they are less likely to benefit from these tax breaks. In California, Black, Latinx, and Pacific Islander households own homes at rates below the state average of 55%, while American Indian, Asian, and white households own homes at rates at or above the state average.⁹ In addition, many homeowners of color have lower-valued homes — largely due to residential segregation and racially biased appraisal practices — and therefore generally lower mortgage interest and property tax expenses, resulting in smaller tax benefits for these expenses.¹⁰ Moreover, these tax benefits are unlikely to help many families of color become homeowners, since the main barrier to homeownership is down payment costs, not mortgage interest or property taxes.¹¹ By rewarding families who would have purchased homes anyway instead of helping families of color become homeowners, these tax breaks protected by policymakers perpetuate the racial wealth gap. Better-targeted assistance such as down payment assistance or a first-time homebuyer tax credit may be more likely to increase homeownership among these families.



4

Refundable Tax Credits Increase Racial Equity by Boosting Incomes for Low-Income Californians of Color

Refundable income tax credits are the only tax credits that help families with very low incomes.¹² As a result, these credits are more likely to benefit American Indian, Black, and Latinx Californians, who are more likely to have low incomes due to racist economic, education, and employment policies and practices. California has two refundable tax credits, the California Earned Income Tax Credit (CalEITC) and the Young Child Tax Credit, which boost the incomes of Californians with incomes under \$30,000.¹³ Around 3 in 4 Californians eligible for the CalEITC are people of color, including about half who are Latinx.¹⁴ However, the amount the state spends on these two credits is only about 2% of all state spending on tax breaks for individuals. Policymakers could improve racial equity in the state by increasing the CalEITC and the Young Child Tax Credit or by converting other tax benefits into targeted, refundable credits, which would provide greater benefits to lower-income families of color.



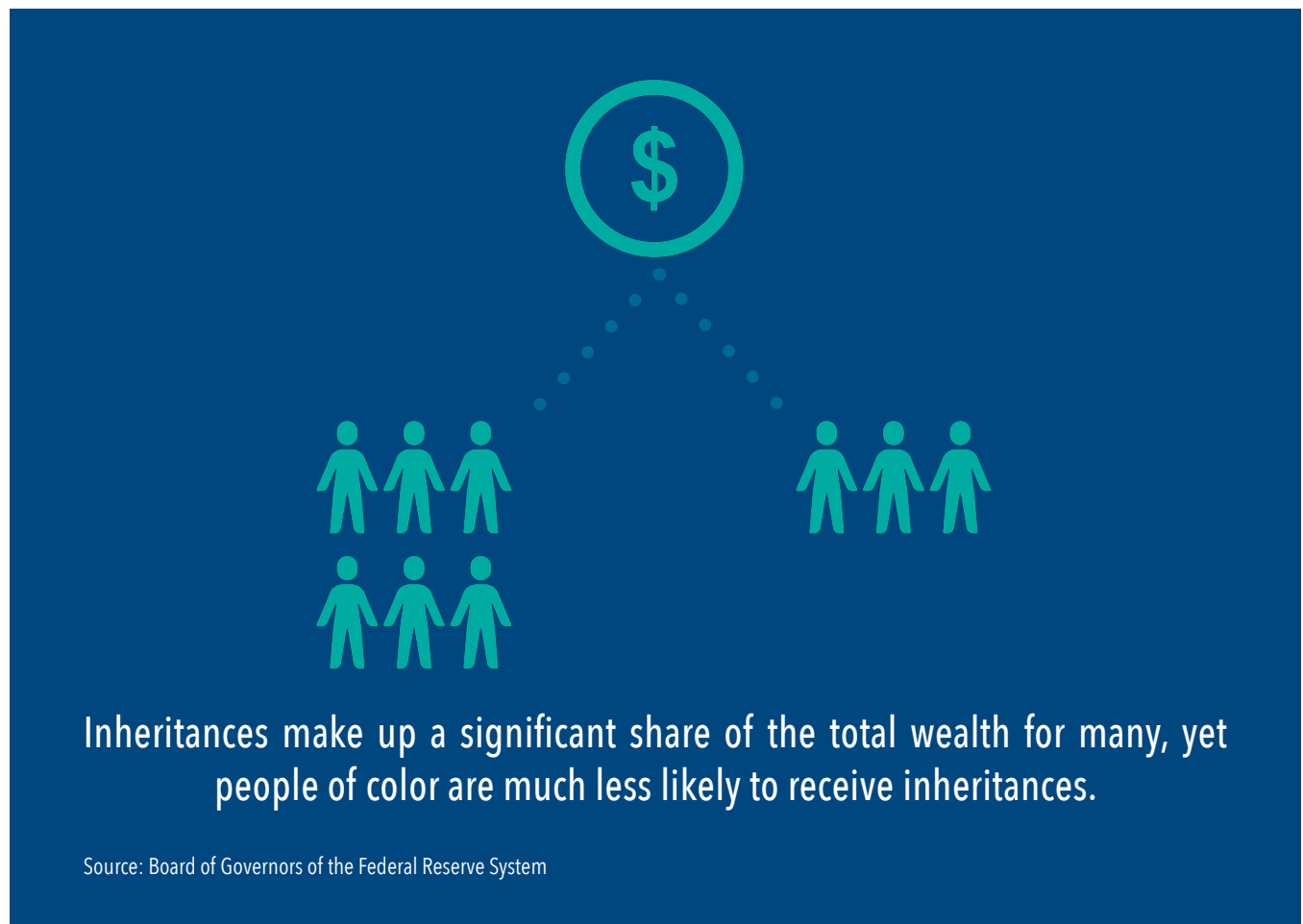
Around 3 in 4 Californians eligible for the CalEITC are people of color, including about half who are Latinx.

Source: Budget Center analysis of US Census Bureau, American Community Survey data

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Taxing Wealth and High Incomes Would Reduce Racial Inequity and Raise Revenue to Help More Californians Thrive

Even before the COVID-19 crisis devastated many communities of color, racist policies and discrimination blocked many of these Californians from accessing well-paying jobs, safe and affordable housing, and a quality education. Meeting these critical needs and building a more equitable California where everyone can thrive will require significant investments supported by additional revenues. Raising needed revenues equitably means asking more from Californians with the greatest ability to pay. Policymakers could significantly narrow racial income and wealth inequality by using these revenues to help people of color boost their incomes and build wealth in the long run. State leaders could explore raising top income tax rates, eliminating or cutting back tax breaks that primarily benefit higher-income people, or tapping into the state's vast wealth with a tax on inheritances, estates, or net worth. California does not directly tax wealth and does not currently have an inheritance or estate tax. Inheritances make up a significant share of the total wealth for many, yet people of color are much less likely to receive inheritances.¹⁵ Reinstating a tax on large inheritances could reduce the racial wealth gap, especially if the revenues were used to increase wealth-building among Californians of color who have been historically locked out of such opportunities.¹⁶



Policymakers Can Build a More Equitable California by Improving Tax and Revenue Policies

The racial, ethnic, and economic inequities that have been made painfully clear by the COVID-19 pandemic and recession are nothing new for California's communities of color. The inequities are the product of centuries of policies and practices that have put Californians of color, particularly Black, Latinx, and American Indian Californians, at a significant economic disadvantage. California's leaders need to do more than help the state recover from the current crisis; they need to change how the state raises and allocates resources to address the long-standing inequities hurting Californians of color.

Policymakers should start by re-examining and restructuring the state's tax and revenue system. The goals of this effort should be twofold. First, policymakers should make the tax code itself more equitable by limiting or eliminating tax breaks that primarily benefit the already wealthy and expanding or creating new tax benefits that reach Californians with low incomes and help families build wealth. For example, the state could increase the CalEITC and Young Child Tax Credit, increase the existing renter's tax credit and make it refundable, provide a tax credit for first-time homebuyers with low and middle incomes, and provide better-targeted incentives to save for retirement.¹⁷ Second, policymakers should explore opportunities to raise sufficient revenues from those who have been provided the most advantage by past racist and classist policies to fund investments to support Californians who have been provided the least advantage. Investments could include moving toward universal health care, making child care, housing, and higher education more affordable, and expanding children's savings accounts or creating a "baby bonds" program to help families save for their children's futures.¹⁸ Policymakers have an opportunity to improve the state's tax code to make the investments needed now to ensure that more Californians have the ability to achieve economic stability and build wealth for their families and future generations.

The Budget Center was established in 1995 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The Budget Center engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of Californians with low and middle incomes. General operating support for the Budget Center is provided by foundation grants, subscriptions, and individual contributions.

Endnotes

¹ However, there are historical examples in California and elsewhere of state and local tax policies that had explicit or implicit racist roots. See Michael Leachman et al., *Advancing Racial Equity with State Tax Policy* (Center on Budget and Policy Priorities, November 2018), 1-2, 10, <https://www.cbpp.org/research/state-budget-and-tax/advancing-racial-equity-with-state-tax-policy>.

² See, for example, Adriana Ramos-Yamamoto and Monica Davalos, *Confronting Racism, Overcoming COVID-19, and Advancing Health Equity* (California Budget & Policy Center, February 2021), https://calbudgetcenter.org/wp-content/uploads/2021/02/R-FP-Health-Equity_.pdf.

³ While Asian families in the aggregate are overrepresented in the top fifth of the income distribution, the aggregated data presented here do not capture the diversity of Asian American communities and the significant economic inequality among them. For example, see Abby Budiman, Anthony Cilluffo, and Neil G. Ruiz, *Key Facts About Asian Origin Groups in the US* (Pew Research Center, May 22, 2019), <https://www.pewresearch.org/fact-tank/2019/05/22/key-facts-about-asian-origin-groups-in-the-u-s/>; Melany De La Cruz-Viesca et al., *The Color of Wealth in Los Angeles* (Duke University, The New School, the University of California, Los Angeles, and the Insight Center for Community Economic Development, 2016), http://www.aasc.ucla.edu/besol/color_of_wealth_report.pdf.

⁴ Budget Center analysis of US Census Bureau, American Community Survey public-use microdata downloaded from IPUMS USA (University of Minnesota, www.ipums.org). These data do not include income from capital gains, which are highly concentrated among high-income households. Households of color are likely to have less income from capital gains than white households because they are less likely to own capital assets, and among those who do, there are large disparities in the value of such assets. Therefore, these data likely underestimate the degree to which households of color are underrepresented in the highest income group.

⁵ Budget Center analysis of US Census Bureau, American Community Survey public-use microdata downloaded from IPUMS USA (University of Minnesota, www.ipums.org). Specifically, American Indian households represent 0.22% of the top 20% compared to 0.4% of all California households, and Pacific Islander households represent 0.22% of the top 20% compared to 0.27% of all California households.

⁶ Neil Bhutta et al., *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances* (Board of Governors of the Federal Reserve System, September 28, 2020), <https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm>. Wealth is defined by net worth, which is the difference between a family's assets and their liabilities, in other words, what they own minus what they owe. Data on net worth is not provided separately for other racial and ethnic groups.

⁷ Department of Finance, *Tax Expenditure Report 2020-21*, 7-8, https://dof.ca.gov/Forecasting/Economics/Tax_Expenditure_Reports/documents/Tax_ExpenditureReport_2020-21.pdf; Kayla Kitson, *Tax Breaks: California's \$60 Billion Loss* (California Budget & Policy Center, January 2020), https://calbudgetcenter.org/wp-content/uploads/2020/01/CA_Budget_Center_tax-expenditures-2020.pdf.

⁸ The "richest 20% of families" refers to the top 20% of tax filers when ranked according to Adjusted Gross Income. For tax year 2017—the most recent year for which data on the distribution of tax benefits are available—the lowest income of a tax filer in the top 20% was \$102,454. See Franchise Tax Board, Department of Finance Tax Exhibits (Spring 2020), Exhibit A-12, <https://data.ftb.ca.gov/Other/Department-of-Finance-Tax-Exhibits-Spring-2020/2j3i-8tez>.

⁹ Budget Center analysis of US Census Bureau, American Community Survey public-use microdata downloaded from IPUMS USA (University of Minnesota, www.ipums.org).

¹⁰ Budget Center analysis of US Census Bureau, American Community Survey public-use microdata downloaded from IPUMS USA (University of Minnesota, www.ipums.org); Junia Howell and Elizabeth Korver-Glenn, *Race Determines Home Values More Today than it Did in 1980* (Rice University, Kinder Institute for Urban Research, September 2020), <https://kinder.rice.edu/urbanedge/2020/09/24/housing-racial-disparities-race-still-determines-home-values-America>.

¹¹ Christian A. L. Hilber and Tracy M. Turner, “The Mortgage Interest Deduction and Its Impact on Homeownership Decisions,” *The Review of Economics and Statistics* 96, no. 4: 618-637, https://doi.org/10.1162/REST_a_00427; US Library of Congress, Congressional Research Service, *The Mortgage Interest and Property Tax Deductions: Analysis and Options*, by Mark P. Keightley, R41596 (Updated March 18, 2014), 13-15, <https://crsreports.congress.gov/product/pdf/R/R41596/9>.

¹² With a refundable tax credit, if a family is eligible for a credit that exceeds the amount of taxes they owe, they can receive the balance as a refund.

¹³ For more information about the CalEITC and the Young Child Tax Credit, see Alissa Anderson, *The CalEITC and Young Child Tax Credit: Smart Investments to Broaden Economic Security for Californians* (California Budget & Policy Center, October 2019), https://calbudgetcenter.org/wp-content/uploads/2019/10/CA_Budget_Center_1055-CalEITC-Chartbook-Update-October-2019.pdf.

¹⁴ Anderson, *The CalEITC and Young Child Tax Credit*, 36. Families eligible for the CalEITC are also eligible for the Young Child Tax Credit if they live with at least one child under age 6.

¹⁵ Bhutta et al., *Disparities in Wealth by Race*.

¹⁶ Because voters in 1982 approved a change to state law to prohibit the enactment of future taxes on estates or inheritances, a reinstatement of an inheritance tax would need to be approved by voters.

¹⁷ See, for example, Emanuel Nieves, Joanna Ain, and David Newville, *From Upside Down to Right-Side Up: Turning the Tax Code into an Engine for Economic and Racial Equality* (Prosperity Now, July 2020), 32-36, https://prosperitynow.org/sites/default/files/resources/RSU_2020_Full_Report-7.13.2020.pdf. This report focuses on federal policy proposals, but the policies could be adapted and scaled to the state level.

¹⁸ For more on children’s savings accounts and a proposal for a national “baby bonds” program, which could be adapted and scaled to the state level, see Darrick Hamilton et al., *A Birthright to Capital: Equitably Designing Baby Bonds to Promote Economic and Racial Justice* (Prosperity Now and the Ohio State University Kirwan Institute for the Study of Race and Ethnicity, February 2020), <https://prosperitynow.org/resources/birthright-capital-equitably-designing-baby-bonds-promote-economic-and-racial-justice>. In 2019, the California Kids Investment and Development Savings Program was enacted and will provide seed deposits for college savings accounts for children born on or after July 1, 2020, but only \$25 million has been allocated to this program and seed deposits for each account could be as little as \$25.