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Little support for repealing SALT deduction cap as Senate taxwriters discuss racial inequities in the tax code

Proposals to repeal or roll back the current-law cap on the deduction for state and local taxes (SALT) came in for criticism from several Senate Republican taxwriters – and one witness invited by Democrats – at an April 20 Finance Committee hearing addressing "racial, ethnic, and gender disparities in the tax code."

Outsized benefits for the wealthy?

The $10,000 cap on the SALT deduction, which was enacted in 2017's Tax Cuts and Jobs Act (TCJA, P.L. 115-97), is scheduled to expire in 2026. The deduction had been unlimited before the TCJA became law and tends to be used more heavily in higher-taxed "blue" states, such as New Jersey, New York, Connecticut, and California; however, lawmakers in both parties who represent jurisdictions with expensive housing markets and steep property and income taxes have said the cap imposes undue burdens on their constituents and could erode the tax base in some localities as residents move to lower-tax areas. In the current Congress, calls to repeal the cap – or at least relax it – have come largely from the House, and various contingents of mostly Democratic lawmakers in that chamber have indicated that they might withhold support for any forthcoming tax legislation that does not address their concerns. (See separate coverage in this issue for additional discussion.) President Biden did not include modifications to the SALT deduction cap in the outline of his $2 trillion-plus American Jobs Plan, although White House officials have said the administration is open to discussing that issue if supporters also provide appropriate revenue offsets.

At the Finance Committee hearing, several Republicans, citing an analysis from the nonpartisan Joint Committee on Taxation staff, argued that benefits of the SALT deduction accrue primarily to upper-income taxpayers and that capping the deduction in the TCJA was a step in promoting tax code fairness. Ranking member Mike Crapo, R-Idaho, characterized efforts to repeal the cap as "[g]oing the opposite direction of combating inequality in the tax code."

The GOP's sole invited witness, Shay Hawkins, a former tax counsel to GOP Finance Committee member Tim Scott of South Carolina and currently the CEO of the Opportunity Funds Association, agreed with that assessment. In an exchange with Sen. Patrick Toomey, R-Pa., Hawkins stated that there is "no intellectually honest argument to raise the SALT cap if your goal is to eliminate inequality in the tax code."

Finance Committee Democrats, for their part, offered no comments on the SALT deduction cap or on proposals to repeal it. But one of their invited witnesses – Dorothy Brown of the Emory University School of Law – agreed with the panel's Republicans that eliminating the cap would be a boon to wealthy individuals and do little for lower- and middle-income taxpayers. (That position also aligns her with lawmakers in the more progressive wing of the Democratic party, such as Rep. Alexandria Ocasio-Cortez of New York, who recently said that repeal would "unequivocally" benefit "the richest people," although she was open to a discussion of raising the cap above $10,000. For prior coverage, see *Tax News & Views*, Vol. 22, No. 20, Apr. 16, 2021.)
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But Brown, author of *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans – And How We Can Fix It*, went a step further and stated in response to a question from Sen. Steve Daines, R-Mont., that the SALT deduction itself should be repealed, along with all other itemized deductions for individuals in the tax code.

Brown told the panel in her opening statement that many of the current-law tax deductions, credits, and incentives for individuals were enacted at a time “when separate but equal was the law of the land.” In an exchange with Democratic Sen. Debbie Stabenow of Michigan, she explained that her research showed that these provisions disproportionately benefit white taxpayers over Black taxpayers at all income levels when they engage in similar economic activities such as buying a home or saving for retirement.

Revisiting other TCJA provisions

Taxwriters in both parties cited other TCJA provisions as examples of how the tax code can address racial inequities in the tax code or how it can exacerbate them.

Passthrough deduction: Montana Republican Sen. Steve Daines called the TCJA’s 20 percent deduction for passthrough entities, which is currently set to expire at the end of 2025, “a critical part of tax reform” and argued that making the provision permanent would benefit minority entrepreneurs, who generally organize their businesses as passthroughs rather than corporations.

Witness Shay Hawkins agreed that the bulk of minority-owned small businesses are formed as sole proprietorships, partnerships, or limited liability companies. Making the 20 percent passthrough deduction permanent, he said, would have “a strong, targeted effect on benefiting minority small business owners.”

But Colorado Democratic Sen. Michael Bennet argued that the bulk of minority-owned businesses tend to be “owner-only” firms with few employees on the payroll. The design of the TCJA’s passthrough deduction, he said, provides the smallest benefits to the smallest businesses and does not “help small, minority-owned businesses succeed compared to their larger, often white-owned competitors.”

Witness Dorothy Brown agreed with Bennet’s conclusion.

Opportunity Zones: Several Republicans on the panel touted the TCJA’s Opportunity Zone provisions, which are intended to provide tax incentives to encourage investments in economically distressed communities.

In an exchange with Sen. James Lankford, R-Okla., about how to “democratize” the current-law rules, Shay Hawkins (who worked on those rules while serving on Sen. Tim Scott’s staff) encouraged taxwriters to enhance the program by allowing non-capital gain investments in businesses located in an Opportunity Zone and providing a 100 percent basis step-up when the business is sold if the investments are held for 10 years or longer. (Under the current rules, tax benefits for Opportunity Zones are limited to investments of unrealized capital gain.)

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But Democratic taxwriter Sheldon Whitehouse of Rhode Island asked Dorothy Brown whether the Opportunity Zone rules as written run the risk of benefiting wealthy investors rather than the distressed communities they are intended to serve.

Brown replied that although there is anecdotal evidence that Opportunity Zones have been successful in bring economic development to some communities, there is also evidence to suggest that some Opportunity Zone grants have been awarded to certain wealthy investors based on political rather than economic considerations and that some investors have been able to influence decisions around which areas receive Opportunity Zone designations. The rules as written, she said, provide "a lot of leeway" that make the program "not as helpful to distressed communities" as it could be.

Capital gains and deferral

Finance Committee Chairman Ron Wyden, D-Ore., asked Brown about how disparities in the rates of stock ownership between Black and white taxpayers exacerbate racial inequities in the tax code. Brown said her research indicates that wealthy taxpayers, who are more likely to be white, own more stock than Black taxpayers, and that as a result a greater share of their income is taxed as capital gains, which receive preferential tax treatment compared to income from labor. (In a later exchange with Sen. Bob Casey, D-Pa., she said that the government could level the playing field by taxing capital income at the same rate as earned income.)

Brown also noted to Wyden that individuals with significant capital assets have the option of holding on to those assets indefinitely – thereby deferring taxation – and then passing them on to their heirs at death subject to a 100 percent step-up in basis.

Other tax policy prescriptions

Several Democrats on the panel looked to temporary enhancements to the child tax credit and the earned income tax credit (EITC) that were enacted in President Biden's American Rescue Plan Act of 2021 (P.L. 117-2), the emergency relief bill that was signed into law last month to address the ongoing economic and health impacts of the COVID-19 pandemic, as examples of concrete steps lawmakers can take to help lift low-income individuals – particularly children – out of poverty.

Among other things, the new law the made the child tax credit fully refundable and partially advanceable, increased the credit amount to $3,000 per child ($3,600 for a child under age 6), and increased the age limit for a qualifying child to 17, all effective for 2021 only. It also expanded eligibility for and the amount of the earned income tax credit for taxpayers with no qualifying children (the "childless EITC") for 2021. (For additional details, see *Tax News & Views*, Vol. 22, No. 11, Mar. 10, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210310_1.html

In an exchange with Colorado's Michael Bennet, Dorothy Brown called the provision to make the child tax credit fully refundable "a sea change" and agreed that it should be made permanent.

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Witness Mihir Desai of Harvard University likewise told Bennet that the temporary expansion of the childless EITC was "wonderful news" that would make inroads in reducing poverty and promoting racial equity in the tax code.

In other comments during the hearing, Desai also urged taxwriters to develop policies that are "laser focused" on the needs of lower-income families. He cautioned that broad calls to tax billionaires and large corporations under the banner of addressing income inequality can be "problematic" because they run the risk of shifting attention away from the plight of individuals at the bottom of the income scale. In developing revenue-raising proposals, Congress needs to focus specifically on where that revenue would go and how it would be used, he added.

Audit disparities

Sen. Elizabeth Warren, D-Mass., and other Democratic taxwriters contended that the issue of racial inequity encompasses not just what is in the tax code but how tax laws are enforced, noting a recent report from the Treasury Inspector General for Tax Administration suggesting that the IRS tends to audit lower-income taxpayers – particularly those claiming the EITC – at higher rates than wealthy individuals.

According to Warren, years of cuts to the IRS's budget have eroded the agency's enforcement resources and made it "easier and cheaper" for the Service to audit lower-income taxpayers rather than wealthy individuals who often employ sophisticated tax strategies and can afford expensive legal resources to prolong litigation. She also noted that she plans to introduce legislation that would classify the enforcement component of the Service's budget as mandatory spending to enhance its ability to focus its audit efforts on the high-income sector – an approach that IRS Commissioner Charles Rettig endorsed at a recent Finance Committee hearing on the 2021 tax filing season. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 20, Apr. 16, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210416_3.html

Dorothy Brown agreed with Warren that boosting the IRS's enforcement budget and mandating that the agency increase its audit focus on high-income taxpayers would help reduce racial disparities in the tax code.

"It would make who pays taxes a lot fairer," Brown said.

Data transparency

Finance Chairman Wyden contended that a key stumbling block to addressing racial disparities in the tax code is the fact that the IRS does not collect race-based demographic data from taxpayers.

Brown cited that issue in her remarks to the panel, noting that the lack of available data from the IRS forced her to rely on racial statistics collected by other government agencies as a proxy in conducting research for her book. Responding to a question from Democratic Sen. Bob Casey, she argued that the IRS's *Statistics of Information* should include data based on race – something she said the IRS could capture on the Form 1040 –

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so that lawmakers and the public can better understand which segments of the population benefit from specific tax code provisions.

Wyden told the panel that “is long past time to make it easier to obtain the key tax data that will illuminate the injustices in our tax law.” Although he acknowledged inherent privacy concerns, he said that the necessary data gathering “can be done in a manner that protects the confidentiality and privacy of all taxpayers” and told taxwriters he will be asking them to work with him “to implement this long overdue and essential transparency reform.”

Next up: ‘Creating opportunity’

Senate taxwriters will explore additional issues related to equity in the tax system at an upcoming hearing by the Subcommittee on Fiscal Responsibility and Economic Growth on “creating opportunity through a fairer tax code.”

That hearing is set for April 27. A witness list was not available at press time.

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