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Beverly I. Moran

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# EXPLORING THE MYSTERIES: CAN WE EVER KNOW ANYTHING ABOUT RACE AND TAX?

BEVERLY I. MORAN\*

In *A Black Critique of the Internal Revenue Code*,<sup>1</sup> Bill Whitford and I studied four important applications of the individual income tax: to income from wealth, to the expenses of home ownership, to income in the form of employee benefits, and to marriage.<sup>2</sup> With respect to those applications we compared similarly situated blacks and whites, as defined by standard socio-economic characteristics,<sup>3</sup> in order to determine which group benefited more from what we called “tax benefits.”<sup>4</sup> Along with Congress and the majority of the tax academy, we used the comprehensive income tax ideal to define what we meant by a “tax benefit.” If you read *A Black Critique of the Internal Revenue Code*, I believe you will be convinced that: (1) race has important Code effects; and (2) there are legitimate ways to demonstrate those effects.

## I. INFLUENCING THE CODE: THE BLACK CONGRESS METAPHOR

At its most basic level, asking whether the Code has race effects is asking whether groups can influence the Code. That some groups and individuals have that power is, I think, generally accepted.<sup>5</sup> One step up from knowing that influence can shape Code provisions is asking how influence might work. To illustrate how race might affect

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\* Professor of Law, University of Wisconsin. Visiting Fulbright Professor of Law, University of Asmara, 1996-98. I would like to thank Professor William Whitford for his helpful comments on an earlier draft.

1. Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751.

2. *See id.* at 755.

3. *See id.* at 818-20.

4. *See id.* at 751-55.

5. *See* JEFFREY H. BIRNBAUM & ALAN S. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM (1987); *see also* Richard L. Doernberg & Fred S. McChesney, *Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. REV. 891 (1987) (reviewing BIRNBAUM & MURRAY, *supra*); Lawrence Zelenak, *Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?*, 44 TAX L. REV. 563, 564-65 (1989) (discussing the Louis B. Mayer amendment that saved \$2 million in taxes).

Code applications, Bill Whitford and I created a thought experiment we called the “Black Congress.”

Is it possible that a Congress made up primarily of one type of person might create legislation that favored that type over others? If we looked at a Congress made up of Ku Klux Klan members, would anyone doubt that tax legislation might look different from our present regime? Would a Gay Congress or a Female Congress make different choices? There is certainly scholarship that suggests these differences.<sup>6</sup>

We have just engaged in a thought experiment. Thought experiments are a valued method in both legal and non-legal philosophy.<sup>7</sup> To illustrate how the Code might impact blacks and whites differently, we imagined a Black Congress—a Congress made up solely of blacks and focusing solely on the self-interest of blacks as a group—and asked what tax provisions it might enact. We guessed that a Black Congress would enact some substantially different rules in the areas we studied, rules that favored lifestyle characteristics of blacks as opposed to whites or other ethnic groups.

## II. INTENT VERSUS EFFECT

The Black Congress metaphor illustrates how differentiation by race in the application of Code provisions is possible even in the absence of any conscious, or even unconscious, desire to create a race-biased Code. My point is that legislators who share the same background might create codes that favored their group without necessarily having any conscious, or even unconscious, ill will. This favoritism is possible because in America race carries with it more than color.<sup>8</sup>

One way that race carries more than color is how race shapes

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6. See, e.g., Patricia A. Cain, *Same-Sex Couples and the Federal Tax Laws*, 1 *LAW & SEXUALITY* 97 (1991); David L. Chambers, *What If? The Legal Consequences of Marriage and the Legal Needs of Lesbian and Gay Male Couples*, 95 *MICH. L. REV.* 447 (1996).

7. See, e.g., JOHN RAWLS, *A THEORY OF JUSTICE* (1971) (using a thought experiment to determine principles of justice by asking what principles would be agreed upon by persons in a hypothetical position of equality, with limited knowledge about their real life situation).

8. To say that race carries with it more than color is saying less than we already know from life in America. For example, we already know that race is so powerful that it can even operate in the absence of color. This is the import of Judy Scales-Trent's and Greg Williams's works on their lives as “white” black people in America. See JUDY SCALES-TRENT, *NOTES OF A WHITE BLACK WOMAN: RACE, COLOR, COMMUNITY* (1995); GREGORY HOWARD WILLIAMS, *LIFE ON THE COLOR LINE: THE TRUE STORY OF A WHITE BOY WHO DISCOVERED HE WAS BLACK* (1995).

people's lifestyles over generations. Not only do these lifestyles go beyond color, they go beyond money and other significant class markers.<sup>9</sup> In fact, what social science tells us is that blacks and whites lead lives so different that race shapes where they live, what they learn, and what they own. Another result of race in America is social isolation so that each group knows little or nothing about the other. These two factors taken together, social isolation and social difference, mean that the decisionmaking group can act to further causes that it truly believes are in everyone's best interest while in fact favoring its group over others. This is why we can see race effects without intent. The rule itself is intended, but the hidden race effect is not. Further, because the Code itself is so complex and layered, the disadvantaged group may have no idea that it is being ill treated.<sup>10</sup> After all, even Supreme Court Justices admit to finding taxation a baffling affair.<sup>11</sup>

### III. SELECTING A BASELINE

Any discussion of discrimination in the Internal Revenue Code presumes that we can know a non-discriminatory Code when we see one. We used the comprehensive income tax ideal as our definition of a non-discriminatory Code.

The comprehensive income tax ideal has a special place in tax scholarship. For example, the tax expenditure budget that Congress uses to estimate the cost of tax benefits is based on an ideal comprehensive income tax.<sup>12</sup> We mimicked the tax expenditure budget by defining tax benefits as any deduction or exclusion from income that is inconsistent with the comprehensive income tax ideal.<sup>13</sup> In this regard, we follow traditional tax policy analysis.

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9. As we show in our review of the social science literature on race differences and wealth, the gap between blacks and whites on such standard matters as home ownership and savings is highly influenced by race even when people of the same age, marital status, education level, number of children, region, and area type are compared. See Moran & Whitford, *supra* note 1, at 818-20.

10. This tendency to favor white lifestyles exists even when black ways of living are arguably better than their white counterparts (for example, the rules that penalize black working wives who raise their families into higher and higher levels of the middle class). See *id.* at 795.

11. See Beverly I. Moran & Daniel M. Schneider, *The Elephant and the Four Blind Men: The Burger Court and Its Federal Tax Decisions*, 39 HOW. L.J. 841, 857 (1996).

12. See *Tax Expenditures Chapter from the President's Fiscal 1998 Budget*, 74 TAX NOTES 915, 930 (1997).

13. Under an ideal comprehensive income tax system, all income is taxed at some point. Further, this tax event should occur sooner rather than later. See Beverly I. Moran, *One Tax Piece of the Savings and Loan Crisis: Can the Federal Home Loan Bank*

## IV. USING CONTROLS

Our objective was to test whether the Code taxed blacks and whites, as groups, differently. To do this, we could not simply compare the per capita tax liabilities of blacks with whites. The Internal Revenue Code is intentionally structured to differentiate between economic classes. That is the very nature of vertical equity. Accordingly, differences across class boundaries show a Code intent.<sup>14</sup>

To test our hypothesis, therefore, we needed to compare blacks and whites who should, according to the comprehensive income tax ideal, be taxed similarly. Because we could demonstrate that blacks and whites who are similar by the tenets of that ideal are not taxed similarly, we concluded that the Code treats taxpayers differently by race. Because blacks and whites, as groups, have different lifestyles, they receive both different tax benefits and different tax liabilities.

Considerations other than income and race can account for lifestyle differences. It is possible that some other factors (for example, average age, since blacks have a lower life expectancy) account for the racial differentials in tax liability that we observed. One of the most difficult methodological questions we faced was what factors other than income and race to use as controls (that is, independent variables) in our regression equations for ascertaining the determinants of differential tax liability. Both the text and our

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*Board Use the Internal Revenue Code to Bail Out the Ailing Savings and Loan Industry?*, 22 U. TOL. L. REV. 351, 359-67 (1991). Thus, for example, under a comprehensive income tax, increased net worth from both gifts and labor each would get taxed upon receipt. Further, under an ideal comprehensive income tax, many deductions would drop out of our present tax system altogether because those deductions are not needed to determine income. For example, when I buy stock for \$1200 and sell it for \$1500, my income is only \$300. In order to make this calculation work, we subtract out the \$1200 original investment. We need this deduction in a comprehensive income tax in order to determine that taxable income is \$300 and not \$1500. On the other hand, under a comprehensive income tax ideal there is no need to deduct much (perhaps all) home mortgage interest in order to determine income (some home mortgage interest could be considered an investment expense, not a consumption expense). The home mortgage interest deduction is a benefit to people operating under a comprehensive income tax because it is a type of income that is exempted from taxation even though its removal is not needed to determine the "proper" tax base. See generally Glen Arlen Kohl, *The Identification Theory of Basis*, 40 TAX L. REV. 623 (1985) (articulating a theory for determining the tax base).

14. The principle of vertical equity mandates that there should be appropriate differentiation between persons on each income level and those of the levels above and below. The principle prescribes only that there be some differentiation between each group and the next higher and lower groups, and does not specify the amount of differentiation. See 1 BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 3.1.4 (2d ed. 1989).

methodological appendix contained extensive discussion of this issue.<sup>15</sup> In the end, we decided to control for education, spouse's income, region, age, marital status, area type, employment, children, and age of children, in addition to race and income.<sup>16</sup> Even after controlling for all these variables, we found that race was a statistically significant determinant of tax liability with respect to the categories of Code applications we studied.<sup>17</sup>

## V. CONSTRUCTED PROFILES VERSUS ACTUAL RETURN DATA

Having selected a baseline and controls, the next question we had to face was what databases to use for determining the tax liabilities of blacks and whites. Many studies of the differential tax liability of different groups use actual return data, and there are many advantages to this approach. The greatest unknown for any Code is not what it says but how it works. If people do not take advantage of rules, or if they cheat away at the rules, then just studying the written rule without also asking about the applied rule is problematic.

However, a study that measures compliance in addition to tax liability requires either race-coded returns or sophisticated taxpayer surveys. Tax returns are not race-coded and there are no compliance studies by race that address the questions we raise in *A Black Critique of the Internal Revenue Code*. Although tax returns are not coded by race, they can be cross-matched by race through Social Security numbers. However, cross-matching against Social Security numbers requires security clearance.

Without access to actual returns, we were forced to draw our samples from a variety of general population databases that describe life decisions by blacks and whites.<sup>18</sup> From this information, we

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15. See Moran & Whitford, *supra* note 1, at 756-58, 818-20.

16. See *id.*

17. See *id.* at 799-800.

18. The databases used in the data analysis included the *Survey of Income and Program Participation*, which was designed to track entry into and exit from the participation in various government-funded social programs. See *Survey of Income and Program Participation (SIPP), 1991 Panel, Wave2 Core Microdata File*, U.S. Bureau of the Census (1992). We also have drawn on data from the *National Survey of Families and Households*, a survey about work patterns and income resources, home ownership, inheritance, and gifts. See James A. Sweet & Larry L. Bumpass, *The National Survey of Families and Households—Waves 1 and 2: Data Description and Documentation*, Center for Demography and Ecology, University of Wisconsin-Madison (last modified Mar. 21, 1998) <<http://www.ssc.wisc.edu/nsfh>>. We used the *U.S. Census May 1988 Current Population Survey of Employee Benefits* to study race differences in employee benefit plan participation and the *1980 Census, PUMS Couples File* to study the income of

constructed tax liabilities for these groups with respect to the areas of Code application we studied.

Our analysis assumed that all taxpayers took equal advantage of tax benefits available to them. There are some advantages to this approach. A finding of differentials in actual tax liabilities reported by similarly situated blacks and whites could suggest the need for more taxpayer education in some communities, or perhaps simpler forms. A study that looks only at the opportunity to claim tax benefits, as ours did, isolates the rule itself and exposes underlying inequity that cannot be remedied by education alone.

In addition, it would be useful to know what racial disparities exist in the actual enjoyment of tax benefits. Because such a study is best done by using Social Security records to determine the race of actual taxpayers, and because use of these records raises privacy concerns, government is best situated to do that study. I therefore call for Congress to require an annual "Race Expenditure Budget."

The Race Expenditure Budget would parallel the annual Tax Expenditure Budget that Congress has required since 1974. Congressmen and tax scholars use the Tax Expenditure Budget to estimate government losses from tax benefits. Congress should create a Race Expenditure Budget and use it in the same way that it uses the Tax Expenditure Budget. As we stated in our article: "Ignoring the impact that the Internal Revenue Code has on black welfare is a tradition that must stop."<sup>19</sup>

## VI. IS IT NECESSARILY TRUE THAT A CONSUMPTION TAX IDEAL FAVORS WHITES OVER BLACKS?

We based our earlier study exclusively on the comprehensive income tax ideal because it remains the focus of most tax research and because we lacked resources to extend the study further. However, there are competing views of what constitutes an ideal federal income tax. One strong attack on the comprehensive income tax comes from consumption tax advocates.<sup>20</sup> In contrast to the comprehensive income tax, under a consumption tax a receipt is only

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couples and to ascertain the likelihood of receiving a marriage bonus or penalty. See Census of Population and Housing, 1980, Public-Use Microdata Sample, Samples A, B, and C, Couples File, U.S. Bureau of the Census (1983).

19. Moran & Whitford, *supra* note 1, at 803.

20. For an extensive discussion on this issue, see William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1974), and William D. Andrews, *Fairness and the Personal Income Tax: Reply to Professor Warren*, 88 HARV. L. REV. 947 (1975).

taxed when it is consumed.<sup>21</sup> If a Code provision is measured against a consumption (rather than a comprehensive income) tax ideal, there is a different conclusion about what is a tax benefit.

Professor Zelenak believes that a study that measured the Internal Revenue Code against a consumption tax ideal would almost certainly show that the present income tax favors blacks over whites.<sup>22</sup> His argument appears to be that: (1) the present hybrid income/consumption tax has more income than consumption features; (2) the predominance of income tax features within the present Code means that people with investments will always do better under a pure consumption tax; (3) whites have more investments than blacks; and (4) therefore, the present Code is skewed against whites and in favor of blacks.

If we compare whites in gross numbers to blacks in gross numbers, whites will almost always outnumber blacks. This is true whether we are looking at welfare or at memberships on corporate boards. There are simply many more whites than blacks in America.

It is also true that whites own more property than blacks. We spent a great deal of time on this proposition when we studied the tax consequences of investment income in *A Black Critique of the Internal Revenue Code*.<sup>23</sup> As a consequence, more whites than blacks undoubtedly would benefit from a switch to a pure consumption tax system.

In our study, however, we did not limit ourselves to comparing blacks and whites by gross numbers. Instead, we compared blacks and whites who shared the same income—that is, who were similarly situated with respect to the comprehensive income tax ideal. We saw, for example, not only that the capital gains tax benefit (as measured by the comprehensive income tax ideal) favors whites over blacks because more whites own property in gross numbers than blacks, but also that the capital gains tax benefit favored whites in comparison to blacks with the same income because blacks and whites with similar incomes have different rates of investment in

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21. Thus, if I buy stock for \$1200, sell it for \$1500, and reinvest \$1600, I do not have income because I am not consuming; I am investing. When I sell the \$1600 stock and use the money for a vacation, then I have income. For a discussion of the role of realization under a comprehensive income tax, see Moran, *supra* note 13, at 359-63.

22. See Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1521, 1565 (1998).

23. See Moran & Whitford, *supra* note 1, at 763-69; see also MELVIN L. OLIVER & THOMAS M. SHAPIRO, *BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACE INEQUALITY* 97-100 (1995) (observing that whites own more property than do blacks).



items that produce capital gains.<sup>24</sup>

Finding that similarly situated blacks and whites have different tax results is much more significant than a finding that blacks or whites benefit in gross, because different tax results among people with equal incomes implicate the basic normative principle of horizontal equity, so central to decades of tax policy analysis. Only Professor Zelenak believes that blacks and whites should be taxed the same on a per capita basis. It is blacks and whites who are similarly situated, as measured either by a comprehensive income tax or consumption tax ideal, who should be taxed similarly.

## VII. CONTROLS AND ASSET COMPOSITION

In order to test the Code against a consumption tax ideal and still get the same depth of analysis that we achieved when using a comprehensive income tax ideal, we would have to use data that measure "taxable consumption." Only then could we compare similarly situated blacks and whites against a consumption tax ideal. This is a difficult task because the consumption tax includes in its base such items as loan proceeds used for consumption, and this information is not readily available by race.<sup>25</sup>

Assuming it is possible to develop controls for testing the Code against a consumption tax ideal, it is simply not clear how blacks and whites would fare under that ideal in comparison to one another. The uncertainty results from asset composition, a concept we treat in depth in *A Black Critique of the Internal Revenue Code*.<sup>26</sup> We can see how asset composition affects the analysis by looking at the treatment of borrowing against homes for consumption versus investing in interest-bearing accounts.

The Internal Revenue Code does not include the proceeds from home equity loans in the tax base,<sup>27</sup> although a tax would occur under an ideal consumption tax if the monies are used for non-investment purposes. Further, the present Code permits an interest deduction

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24. See Moran & Whitford, *supra* note 1, at 769-71. As explained above, we also controlled for such non-income considerations as education, region of country, marital status, and age to guard against the possibility that these factors, rather than race, accounted for the black/white differences we observed in the enjoyment of capital gains tax benefits. See *supra* text accompanying note 16.

25. See *supra* note 18 (discussing the databases used to develop income controls). Large databases such as these are much more likely to include information about total income than total expenditures.

26. See Moran & Whitford, *supra* note 1, at 769-71.

27. See Mary Louise Fellows, *A Comprehensive Attack on Tax Deferral*, 88 MICH. L. REV. 722, 788 (1990).

on home equity loans even if used for consumption expenditures.<sup>28</sup> These Code features are tax benefits under the consumption tax ideal. Conversely, the receipt of interest income that is held for investment is excluded under the consumption tax ideal. Yet interest income is generally taxed under our present Code.

Data reported in *A Black Critique of the Internal Revenue Code* suggest that, although whites have more interest-bearing investments than blacks, a higher percentage of total investments by blacks are in interest-bearing accounts.<sup>29</sup> Although there is reason to believe that a higher percentage of black wealth than white wealth is invested in housing, it is indisputable that on average blacks have less equity in housing than whites, and black houses appreciate more slowly than white houses.<sup>30</sup> Having more capital investments creates a greater opportunity to borrow against those investments and spend the loan proceeds on consumption.

From this limited information alone, no conclusion can be reached about whether blacks would benefit or suffer, as compared with similarly situated whites, from a switch to an ideal consumption tax. However, reflection on the data about asset composition that we reported in our article makes us much less certain about the outcome of a competent study than Professor Zelenak is.

#### VIII. NONE OF THIS IS SURPRISING

The thing that is the most surprising about this entire Symposium is that there is a symposium at all. Many of the matters discussed in *A Black Critique of the Internal Revenue Code* and the other articles highlighted here are obvious. Our tax system does more than tax revenues. It also tries to shape, punish, and reward behaviors. The Code is subject to influence. Blacks and whites know very little about one another, and whites essentially hold the power to tax. What would make any one of us think that the Code would not have rules that favored whites over blacks?

What is surprising is the resistance to such an obvious observation. This is especially true when the work was done with the standard of care and depth that we exhibited.

In a sense, the very reactions we received confirm our speculations about race in America. Black audiences who have

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28. See I.R.C. § 163(h) (West Supp. 1998).

29. This fact is the most reasonable inference to draw from the data reported in Moran & Whitford, *supra* note 1, at 766 tbl.1.

30. See *id.* at 777-78 (citing and discussing the most relevant study on this topic).

listened to my marriage penalty analysis since 1991 have always immediately understood the point. It was very much akin to the “click” idea introduced by *Ms.* magazine.<sup>31</sup> Whites, on the other hand, tend to find the entire idea baffling and off-putting. What is going on when legal academics have such a huge experience gap that they exhibit such different reactions?

Once again we are comparing people who are the same as defined by a group of socio-economic characteristics. Law professors have more such characteristics in common than more randomly selected groups. Thus, this furor over something that blacks within the group find obvious is a bad sign. Such a wide gap in how we view race in such a finely matched group says more about race in America than a hundred studies. Nevertheless, I think that another study is clearly in order.

In my next study, I will look at several benefits that are tied to low incomes—for example, the earned income credit, old age benefits, and welfare benefits. Obviously these are areas where we would expect more black access to tax benefits. In addition, assuming that I can locate databases that will permit me to design relevant controls, I will define “tax benefits” using both a consumption and a comprehensive income tax ideal. I cannot give results yet, but I suspect that what I find will be interesting.

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31. See Jane O'Reilly, *The Housewife's Moment of Truth*, *MS.*, Spring 1972, at 54 (coining the term “Click” to name those moments in life when a notion crystallizes in a flash of truth); see also Jane O'Reilly, *A Global Click!*, *Ms.*, July-Aug. 1987, at 60 (referring to her coining of the term).