spotlight on
POVERTY and OPPORTUNITY
THE SOURCE FOR NEWS, IDEAS AND ACTION

Why Anti-Poverty Advocates Should Care About Tax Policy
Heather McCulloch, Tax Policy Project

Tax policy was in the spotlight in the final weeks of the 113th Congress as President Obama threatened to veto a $440 billion tax package due to the dearth of benefits for working families. And the issue promises to be on the agenda of the 114th Congress as well.

While negotiations over tax code intricacies may be off of the radar of most anti-poverty advocates, funders, and practitioners working outside of the Beltway, tax policy couldn't be more relevant to those who care about income and wealth inequality and the growing financial insecurity of low- and moderate-income families.

Tax policy, while a crucial tool for collecting government revenue, also subsidizes households to build wealth. But the benefits are often ineffectively targeted and inequitably distributed. Reforming the tax code could lift families out of poverty and help more people build wealth and invest in their future.

In 2013, the U.S. tax code provided more than a half-trillion dollars of tax-code-based subsidies to support individual households to build wealth in the form of deductions, credits, exclusions and preferential rates. Economists and policymakers call these subsidies "tax expenditures" because they're a form of spending through the tax code—like direct spending programs, they provide financial assistance to support specific activities.

However, the majority of the benefits accrue to the wealthiest Americans. For example, the national nonprofit CFED found that the top 1 percent of households received more benefits from these tax subsidies than the bottom 80 percent combined, and the Tax Policy Center found that 70 percent of tax savings from mortgage interest, property tax deductions, and employer-based retirement savings goes to the top 20 percent of households.

With such an inequitable distribution of benefits, public funds are not only subsidizing wealth building—they're fueling inequality. But why aren't lower-income households benefitting?

Part of the answer lies in the benefits' structure: A household that doesn't itemize on their tax returns – and fewer than one-third do – can't access the benefits of the home mortgage deduction or deductions for college tuition and expenses. A worker whose employer offers no benefits can't access tax subsidies associated with saving in an employer-based retirement plan. Households without resources to invest in stocks and bonds can't access the benefits of reduced tax rates on dividends and capital gains. And the list goes on.

Some tax expenditures aim to serve a worthy public goal, but are ineffective as currently structured. For example, research shows that the more than $100 billion in tax expenditures designed to encourage retirement savings had little impact on net savings, due to the fact that wealthier households were shifting existing savings into tax-favored accounts rather than increasing their overall level of savings.

Tax expenditures affect low and moderate-income households in other, detrimental ways. Each dollar that the federal government doesn't collect when a taxpayer claims a deduction, credit, exclusion, or low preferential rate reduces federal revenue. In a tight budgetary environment, lower revenue means more political pressure to cut spending on federal programs that benefit lower-income families.

If tax expenditures are unfair, inefficient, and costly, one would think that more of us would be clamoring to change them. But most tax expenditures are hidden from public scrutiny. Unlike direct spending programs, they're not part of the annual budget and appropriations process, with the exception of refundable credits, so they aren't subject to the public scrutiny given to direct spending programs.

By now, you may be asking what anti-poverty advocates can do. A first step is to connect with coalitions that are leading a call for change. The Tax Policy Project, which I direct, is one such effort. This national initiative was launched in 2013 by a network of foundations and is now co-led by the national nonprofits CFED and PolicyLink. The project is supporting a growing coalition of equity advocates, researchers, tax policy experts, and organizations with deep roots in low-income and communities of color who are calling for a more inclusive, progressive, and equitable tax code.

Together, we're working to advance several types of changes.

We know most low-income households and households of color don't benefit from deductions, exclusions and preferential rates; but they do benefit from tax credits, especially if they're refundable.

Accordingly, Tax Policy Project participants are calling for the preservation or expansion of existing refundable credits (e.g., the Earned Income Tax Credit, Child Tax Credit and American Opportunity Tax Credit); making existing credits refundable (e.g. Saver's Credit); creating new, accessible credits that offer public matching funds (e.g. Financial Security Credit) or turning deductions into credits (e.g. home mortgage tax deduction).

Finally, we're supporting policy reforms that expand access to tax-incented savings through automatic enrollment (e.g. Automatic IRAs) or new, accessible products (e.g. the President's new myRA).

Engaging in the intricacies of tax policy debates may be a daunting undertaking for anti-poverty advocates, but the stakes are too high to sit on the sidelines. As we move into the 114th Congress, it's critical for everyone concerned about wealth inequality and the financial insecurity of lower-income households to call for policies that enable all households to save and invest—in themselves, their families, and a growing national economy.

Heather McCulloch is the director of the Tax Policy Project, a national initiative co-chaired by CFED and PolicyLink.