

Making the Tax Code Work for Everyone, Not Just the Wealthy

Congressional Democrats and the Biden administration are focused on making our tax code work better for all Americans. Currently, parts of the tax system reward wealth over work and allow the richest Americans to avoid paying their fair share. Despite these challenges, the Inflation Reduction Act took important steps to make the tax code more equitable, streamline how Americans file their taxes, and focus audits on wealthy tax cheats. After years of underfunding, the Inflation Reduction Act provided the resources necessary for the IRS to improve taxpayers' experience and make sure that the tax code rewards work, not wealth.

The progressive federal income tax helps level the playing field

Over half of [federal revenues](#) come from the individual income tax. This tax, since its inception, has been used to raise revenue from those who can afford to support public services. The income tax is progressive, meaning that higher-income Americans pay a larger percentage of their income in taxes than low-income Americans. This allows Congress to raise necessary revenues without doing so on the backs of families already struggling to get by.

The federal income tax system is increasingly used to deliver necessary benefits to low-income families through refundable tax credits like the Earned Income Tax Credit (EITC) and the Child Tax Credit. These programs have been and continue to be [vital](#) for reducing poverty. The progressive income tax also [narrows](#) racial income disparities. Specifically, it reduces the income gap between white and Black families from 38% before taxes to 33% after taxes, and cuts the gap between Hispanic and white families from 26% to 17%.

In 2022, Democrats passed the Inflation Reduction Act to further [strengthen](#) the federal tax code to make the wealthiest pay their fair share. For the first time, the law established a tax on stock buybacks, which disproportionately benefit wealthy shareholders. It also set a minimum tax for corporations. Democrats are [working](#) to build on this progress by repealing tax loopholes and strengthening tax credits that level the playing field for all families.

Provisions in the tax code unfairly reward wealth over work

A range of tax loopholes unfairly value wealth over work. They do this by taxing income from work at higher rates than income from wealth. Instead of fixing this, current federal tax [provisions](#) that help families build wealth are overwhelmingly tailored for high-income

Americans. They also [benefit](#) white families more than families of color and cost taxpayers a total of \$529 billion per year.

Income derived from wealth, such as long-term capital gains and qualified dividends income, is taxed at a lower rate than wage income. And inherited capital gains are completely [exempted](#) from taxation. Because of [systemic](#) exclusion from wealth-building opportunities, this makes the wealth gap for families of color [worse](#).

Some of the wealthiest Americans can also [classify](#) part of their earnings as “pass-through” business income rather than personal income. They do this because it effectively lowers their tax rate by reducing their amount of taxable income. The Republican’s Tax Cuts and Jobs Act (TCJA) created this loophole, which reduces the overall tax responsibility of the wealthy and costs the United States \$56.5 billion each year. In fact, in order to make the wealthiest more wealthy, the TCJA [reduced](#) federal revenues by a total of \$545 billion in 2018 and 2019, which directly [worsened](#) the U.S. debt burden.

The TCJA also significantly weakened the estate tax, one of the government’s most powerful tools to address wealth inequality. Under the TCJA, a taxpayer is only [subject](#) to the estate tax if their assets are worth over \$11.4 million for an individual and \$22.8 million for a married couple, which are more than double the previous thresholds. This change [more than halved](#) the number of taxable estates, from around 5,500 in 2017 to less than 2,000 in 2018, exempting all but the richest 0.2% of estates. Additionally, the TCJA [lowered](#) the federal income tax rate for the highest income bracket from 39.6% to 37% and [weakened](#) capital gains taxation.

When combined with the practice of borrowing against “unrealized capital gains”—which can give the wealthy a [source](#) of income that is not subject to standard income taxes—the result is an [effective tax rate](#) of only 8% for a typical billionaire. That’s lower than the tax rate for many firefighters and teachers.

Investments in the IRS can help pursue wealthy tax cheats while improving services for all taxpayers

In order to fairly collect taxes from the very wealthy, the IRS must be able to audit their complex finances when necessary. The Inflation Reduction Act boosted these capacities by [providing](#) \$45.6 billion for improved staffing, legal support, and technology to make sure that revenues are collected correctly and on time. President Biden’s budget [proposal](#) for fiscal year 2024 continues this effort through increased funding for tax compliance.

Importantly, newly confirmed IRS Commissioner Danny Werfel has [stressed](#) that this increased scrutiny of people’s taxes excludes those “who get W-2s or Social Security payments or have a small business.” In keeping with the Treasury’s pledge not to increase audit rates for small

businesses or for households making less than \$400,000 per year, the IRS has [specified](#) that their work will focus on “high-dollar noncompliance” i.e. the wealthy not paying enough in taxes. By investigating the “complex partnership structures, large corporations, and high-income individuals”, which are currently minimally audited, the IRS can collect more revenue from the wealthiest Americans. Other measures can help as well, such as the Biden administration’s proposed basic [reporting requirements](#) for accounts with more than \$10 in interest income.

When the IRS lacks sufficient funding, the wealthiest avoid audits

Prior to the Inflation Reduction Act’s passage, the efforts of Congressional Republicans and the previous administration had starved the IRS of funds for tax enforcement. This led to a “[tax gap](#)”, the difference between taxes owed and taxes paid, of about \$600 billion per year, or \$7 trillion over a decade, and a highly unequal burden of enforcement. When the IRS [lacks](#) staff capacity for complex audits, they focus more on underreporting of common sources of income like wages, and less on more complicated forms like capital gains and pass-through income. That means that wealthier taxpayers who file more [complex](#) returns are more likely to get away with defrauding the public, and that hurts everyone.

In addition, [recent evidence](#) shows that Black taxpayers are 2.9 to 4.7 times more likely to be audited than non-Black taxpayers, even after controlling for income or whether they underreported income. The IRS does not use racial data when choosing who to audit. However, chronic underfunding and [algorithmic biases](#) can create patterns that disproportionately target certain groups. These audits are burdensome, [financially disruptive](#), and do not achieve the goal of maximizing the amount of money the IRS collects.

Low-income Americans face unfair barriers to tax filing

Filing taxes in the United States is [much harder](#) than it is in many other countries. To deal with this issue, private companies have created a \$14 billion [industry](#) that charges Americans to help them file their taxes. Unfortunately, this industry is largely [unregulated](#), and people can be charged [exorbitant fees](#) for [sub-par](#) work. The most vulnerable filers suffer the most, as predatory tax preparers mostly [target](#) EITC recipients and other low-income filers, who are disproportionately people of color. Currently, the IRS is prevented by law from offering taxpayers a free-file tool, but the Inflation Reduction Act created a [feasibility study](#) exploring whether the U.S. government could provide a high-quality public option for tax preparation. Exploring this option and better regulating private tax providers would help creating a fairer and more equitable tax system.

The Inflation Reduction Act also provides \$3.2 billion for [services](#) like taxpayer education, prefilling assistance, and improved funding for the IRS customer service phone line. While the

IRS could only answer [10%](#) of customer service phone calls last tax season, this year they are answering around [90%](#) thanks to the agency's increased staffing and funding.

Democrats are working to strengthen the tax system for all Americans

Under President Biden, Democrats have made significant progress in strengthening the tax code to make it fair for all Americans. The American Rescue Plan's one-year expansion of the [Child Tax Credit](#) lifted millions of Americans out of poverty in 2021, while the Inflation Reduction Act closed loopholes that had benefitted only wealthy shareholders. President Biden's budget for fiscal year 2024 expands on this progress, proposing a 25% minimum tax for billionaires and permanent expansions of low-income tax credits. In addition, the Inflation Reduction Act reversed years of chronic underfunding for the IRS, enabling them to improve their customer service and better focus their audits on wealthy tax cheats.

Though more work needs to be done, identifying loopholes in the tax code is the first step needed to help decrease the disparities between wealthy Americans and everyone else.