

Black-White Differences In Income Tax Liability

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The Same but Different

- Generally, the federal income tax does not refer to race/ethnicity
- Disparities can still arise because factors that affect tax liability are correlated with race/ethnicity (even after controlling for income).
 - Differences in HH composition → Differences in filing status and dependents
 - Differences in education, wealth → Differences in income composition
 - Moran and Whitford (1996) and Brown (2021)

Three Issues:

- “Our hypothesis is that deviations from the ideal of a comprehensive income tax systematically favor whites over blacks” (H1, Moran and Whitford 1996)
- “We believe that even if income is held constant, the Internal Revenue Code systematically disfavors the financial interests of Blacks … [which will] trigger different tax results.” (H2, Moran and Whitford (1996)
- How have previous tax reforms – and how would prospective tax reforms – affect the differences between the groups?

Key Findings – Descriptive Data

- Black and white tax filing units differ systematically.
- On an overall basis, white units have higher income and so face higher average tax rates (on average)
- Even within income deciles, there are systematic differences – For example, white HH, relative to Black HH:
 - Are more likely to file as married filing jointly
 - Are less likely to file as head of household
 - Have fewer dependents
 - Have a smaller share of income in the form of wages
 - Have a larger share of income in the form of capital income (all, tax-preferred and tax-exempt)

Key Findings – Testing MW Hypotheses

- H1: Untaxed forms of income accrue disproportionately to white households
 - On an overall basis and controlling for income
- H2: In the bottom half of the income distribution:
 - Black tax units face lower ATRs than white units
 - Due to differences in filing status and dependents
- H2: In the top half of the income distribution:
 - Black units face higher ATRs than white units
 - Due to higher share of income in the form of wages, which are fully taxed, and less in the form of capital income, which tax-preferred

Key Findings – Tax Policy Changes

- TCJA was regressive, which favors white households. But controlling for income, the income tax provisions have little racial impact.
- ARP significantly reduced ATRs for Black HH compared to white HH in the bottom half of the income distribution, controlling for income (due to temporary CTC, EITC expansion)
- Prospective Reform
 - Base broadening to include more capital income reduces Black ATRs compared to white ATRs
 - Rate increases, holding the base constant, raise Black ATRs relative to white ATRs
 - The results occur because capital income (which is frequently preferred or exempt) is a smaller share of income for Black units compared to white units, holding income levels constant.
- 1970 law shows no differences in Black versus White ATR → racial differences in the tax system have changed over time.

Outline

- Data and methodology
- Descriptive data
- Tests of the two Moran and Whitford Hypotheses
- Effects of Policy Reforms
- Replication of Strauss and Gouveia for 1970 law
- Decomposition of differences in group ATR (Lin and Slemrod)

Overview of Methodology

- No dataset contains information on both race and taxes
 - Treasury, CBO, TPC impute race onto a dataset that contains tax information
 - We compute taxes using a dataset that contains race information and then calculate taxes
 - Basic logic – better to slightly mismeasure tax liability than to assign the wrong race
 - Studies show that assigning race is difficult.
- Several steps
 - Use household data from 1998-2022 waves of the SCF
 - Convert households into tax units (Gale et al. 2022)
 - Calculate AGI, deductions, credit eligibility
 - Compute income tax liabilities using NBER's TAXSIM
 - Construct Expanded Income (EI)

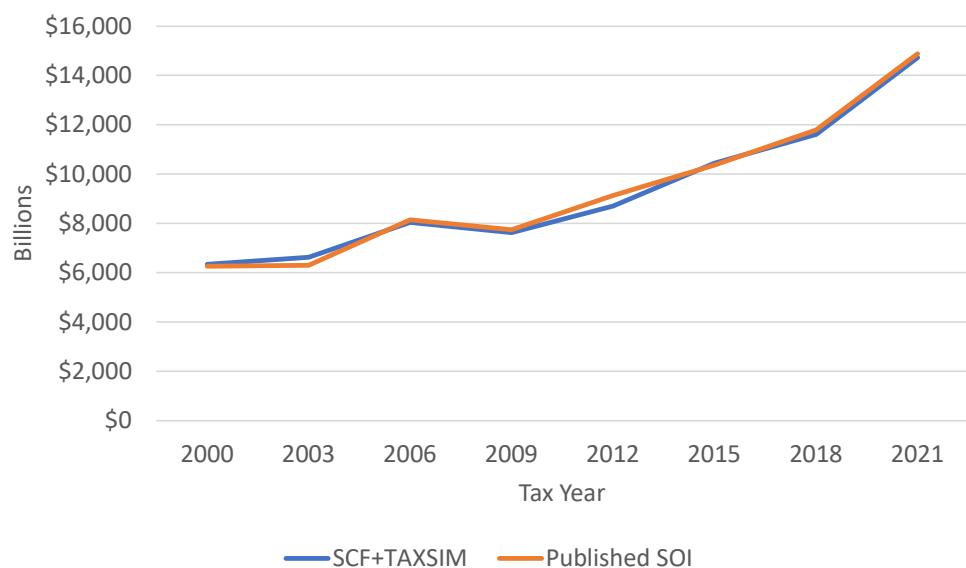
Sample

- We pool nine waves of SCF from 1998 to 2022
 - Each wave surveys about 6,000 families
 - For each observation, the SCF generates 5 imputations (“implicates”) to account for missing data
 - The overall sample contains about 115,000 white tax units and 23,000 Black tax units
- We use SCF weights (divided by nine)
- We convert all dollar items to 2018 dollars (CPI-U)

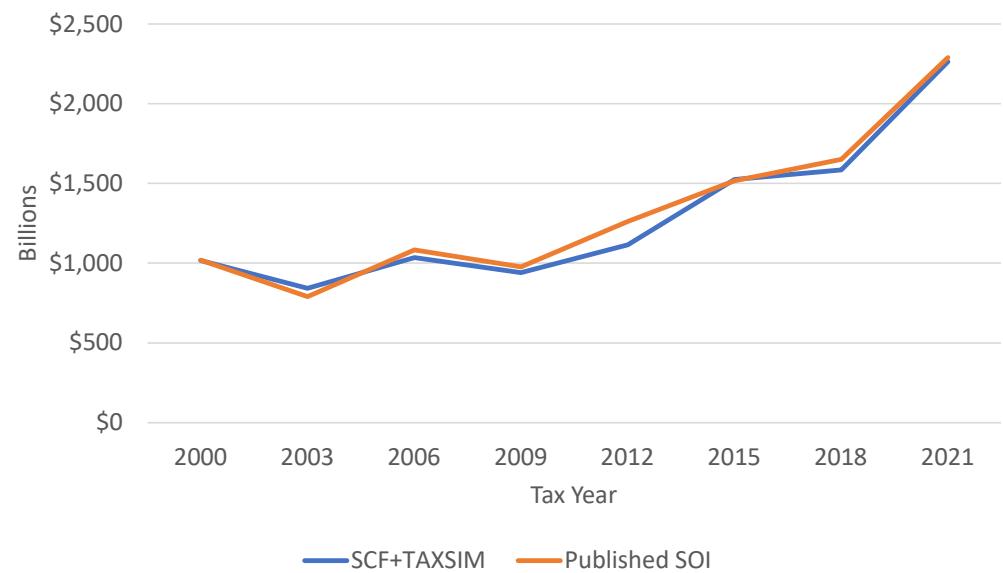
Race Information in the SCF

- Asked consistently since 1998: Seven race categories and respondents can list more than one
- Asked only of the respondent
 - We define the couple (and their children) as the same race as the respondent
 - Only 1% of couples consist of a Black spouse and a white spouse (2010 Census)
- We focus only on respondents who list Black or white as their primary racial identification

Estimated Aggregate AGI vs. SOI Totals



Estimated Aggregate Tax Revenues vs. SOI Totals

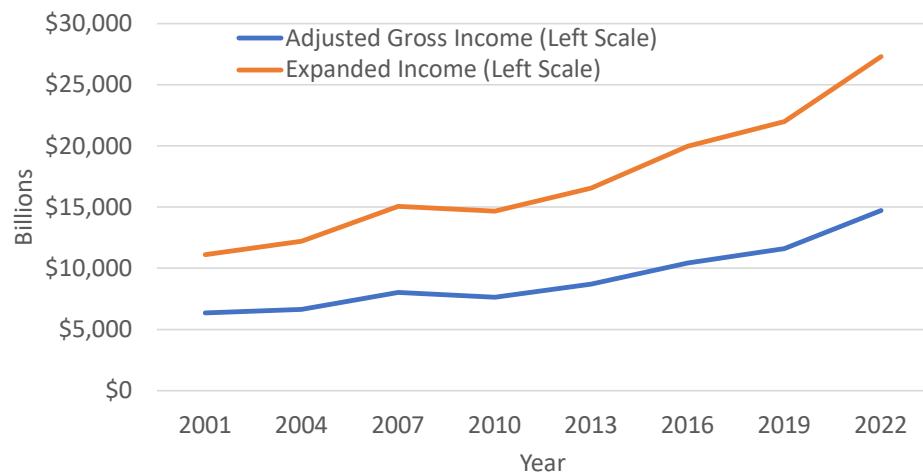


Expanded Income

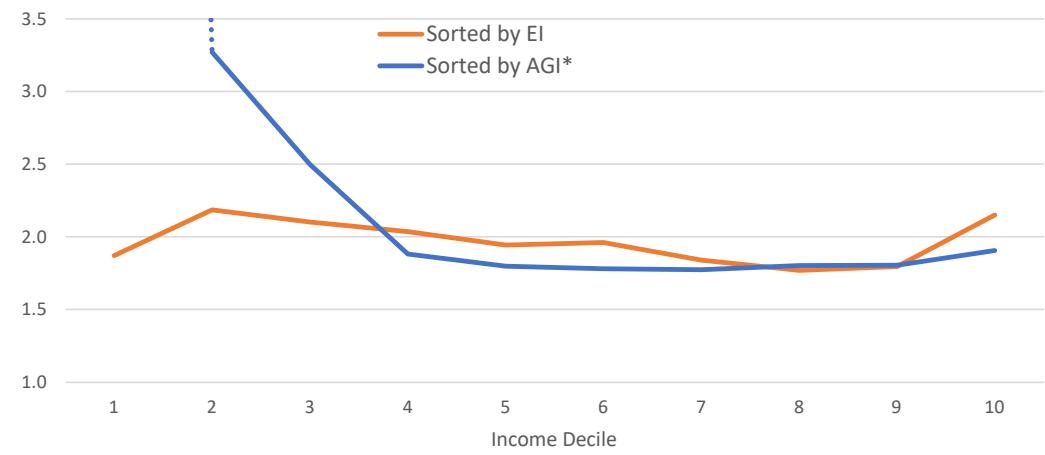
EI includes the following items not in AGI:

Current labor income	<ul style="list-style-type: none">• Tax deductible ER and EE contributions to health benefits• Employer-paid UI and payroll taxes
Retirement income	<ul style="list-style-type: none">• ER and EE contributions to tax-preferred retirement plans• Inside buildup on tax-preferred retirement plans
Capital income	<ul style="list-style-type: none">• Tax-exempt interest• Unrealized capital gains• Untaxed closely-held business income• Imputed rent on owner-occupied housing
Corporate tax burden	
Government transfers	<ul style="list-style-type: none">• Nontaxable Social Security Income• SSI, TANF, SNAP, and other transfers• Medicare and Medicaid
Private transfers	<ul style="list-style-type: none">• Net child support income• Inheritance income

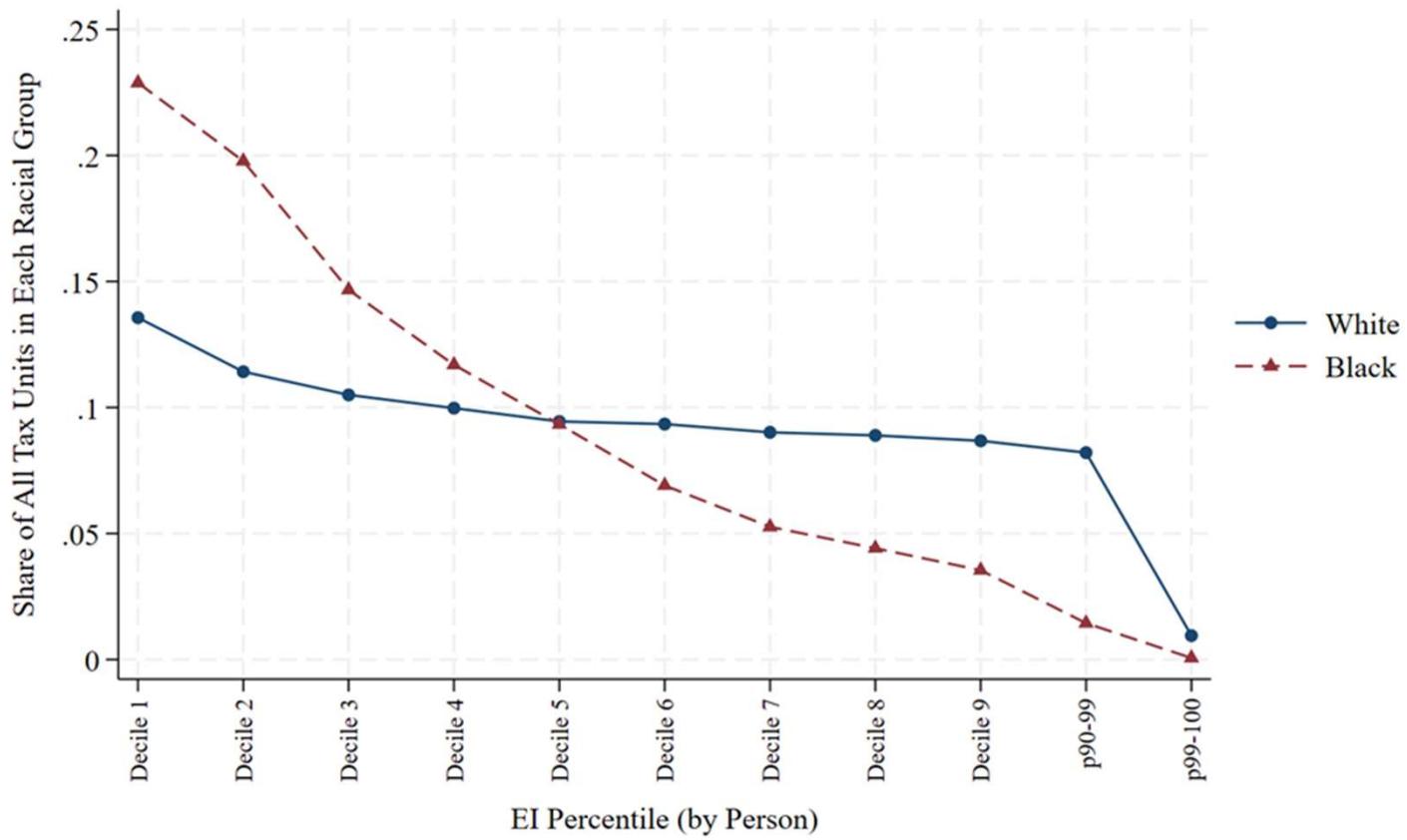
AGI and Expanded Income (EI) Over Time



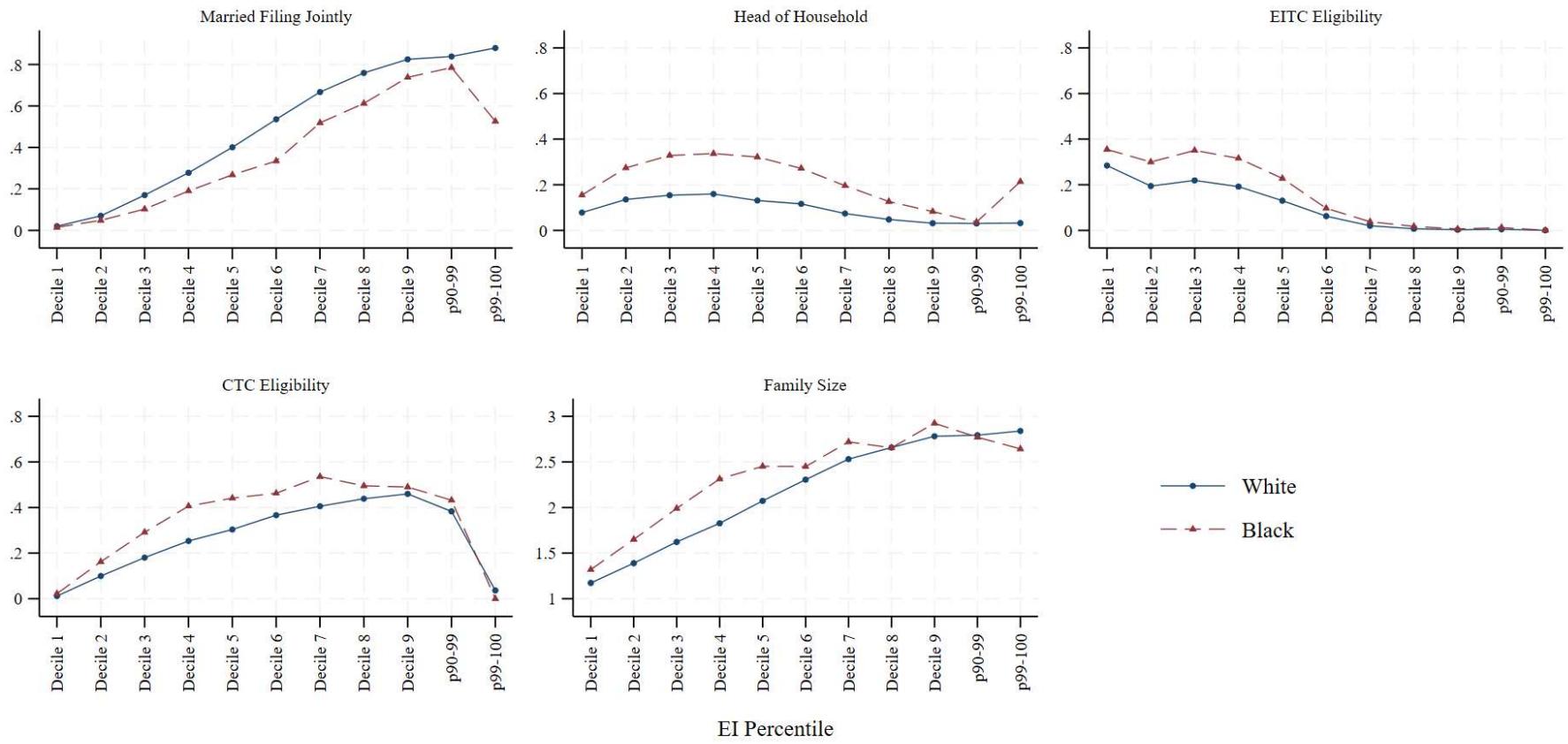
Ratio of EI to AGI across the AGI and EI Distributions



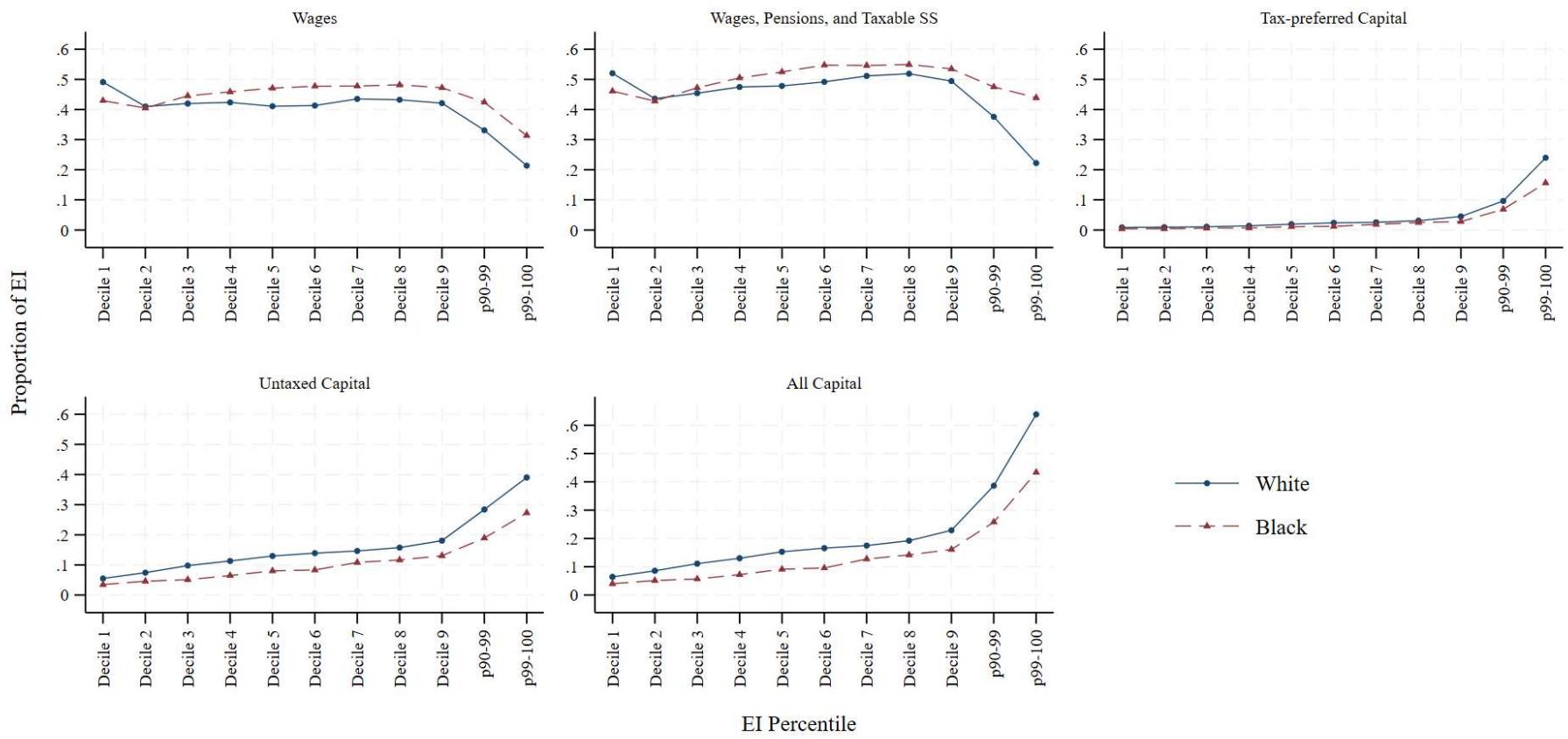
Distribution of Tax Units by EI Percentile



Demographic Characteristics by EI Percentile



Income Composition by EI Percentile

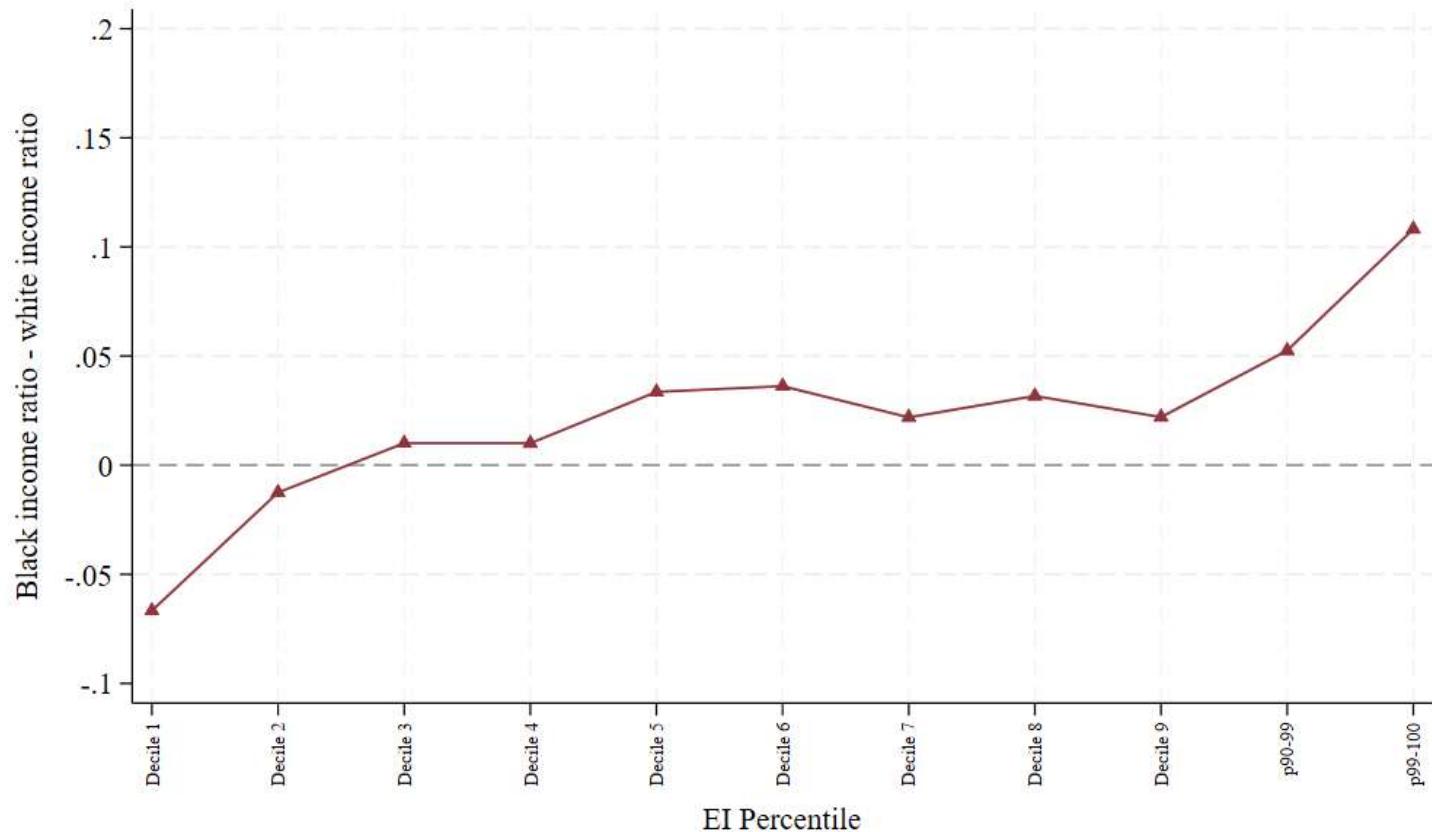


Testing Hypothesis I:

Do Deviations from a Comprehensive Income Tax Systematically Favor White Units Over Black Units?

- We define
 - Comprehensive Income Tax Base = EI
 - Deviations from Base = EI/AGI (higher number = more tax preferences)
 - Very similar results hold if deviations = EI/TI

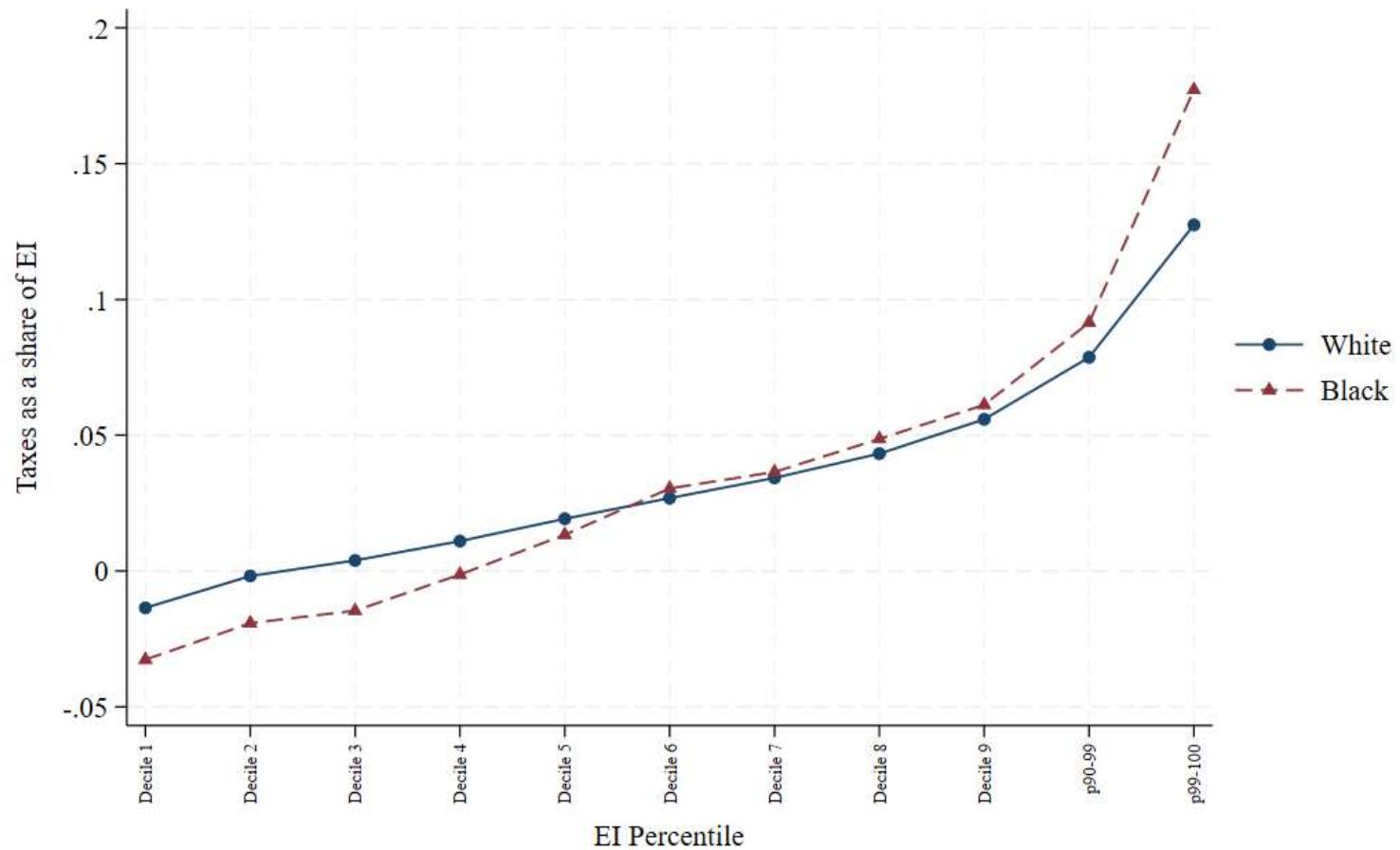
Ratio of Average White EI to Average Black EI by AGI Decile



Testing Hypothesis II:

Holding Income Constant, Does the Income Tax Disfavor the Financial Interests of Black Filers?

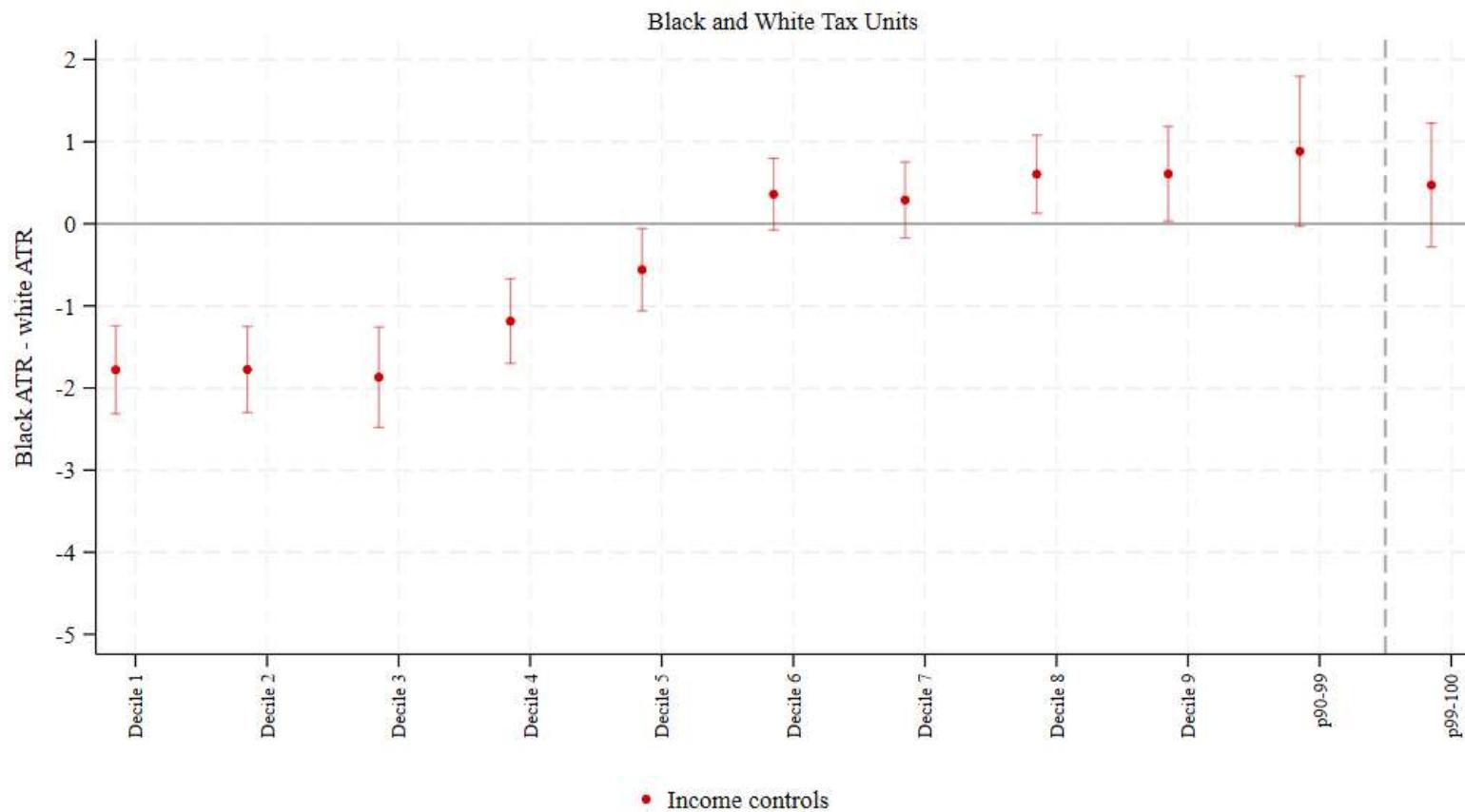
Aggregate Income Taxes / Aggregate EI



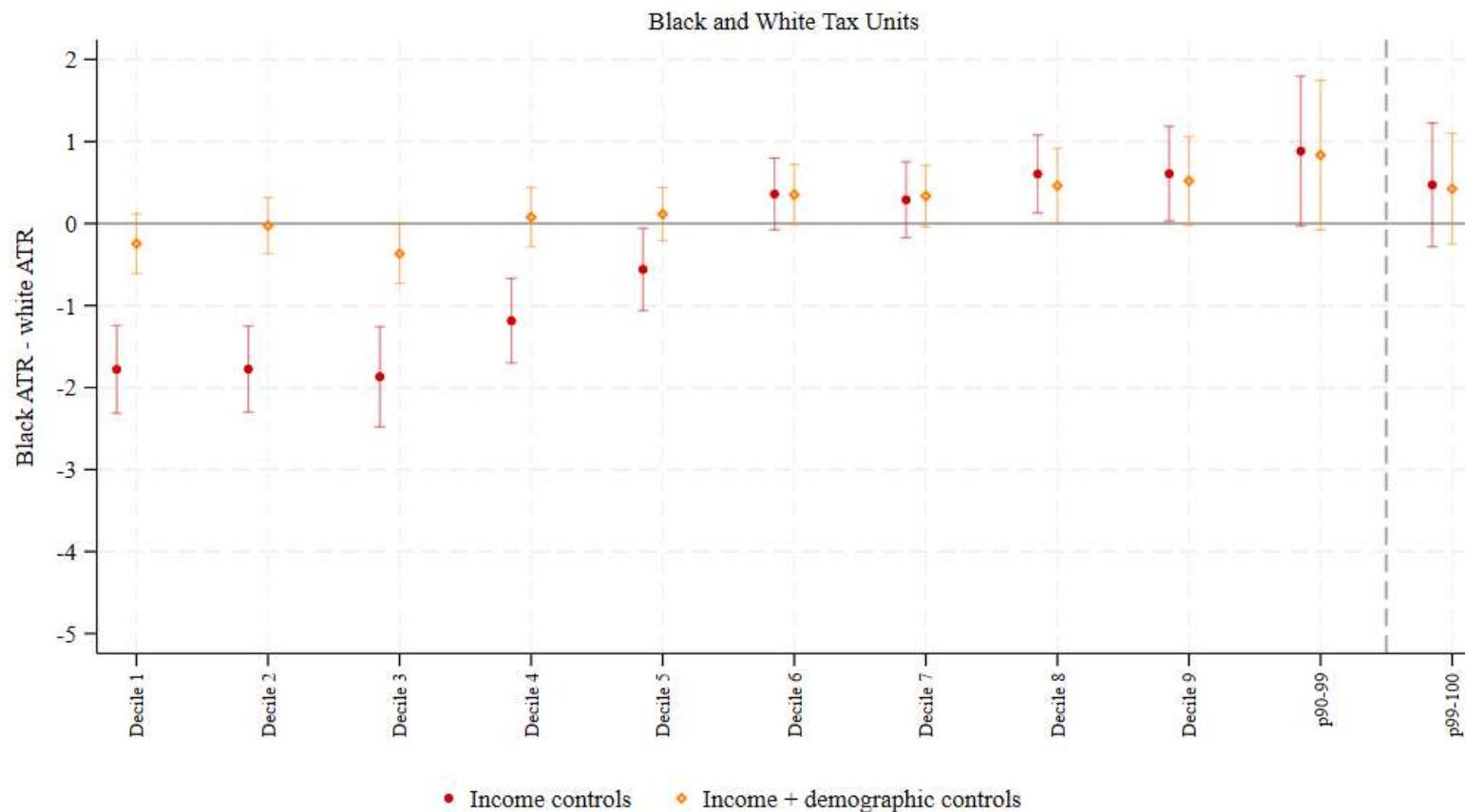
Three Regressions

- Dependent Variable = Tax filing unit's tax liability
- RHS1 = EI and race (all regressions include constant and survey year dummies)
- RHS2 = Adds filing status proxies and number of dependents
- RHS3 = Adds (to RHS2) the share of EI in wages, the share of EI in capital income
- Regressions run separately by EI decile to allow for heterogeneous responses and as a simple way to capture non-linearities in the income tax
- The graphs show the coefficient on the race variable (1 if Black tax unit)

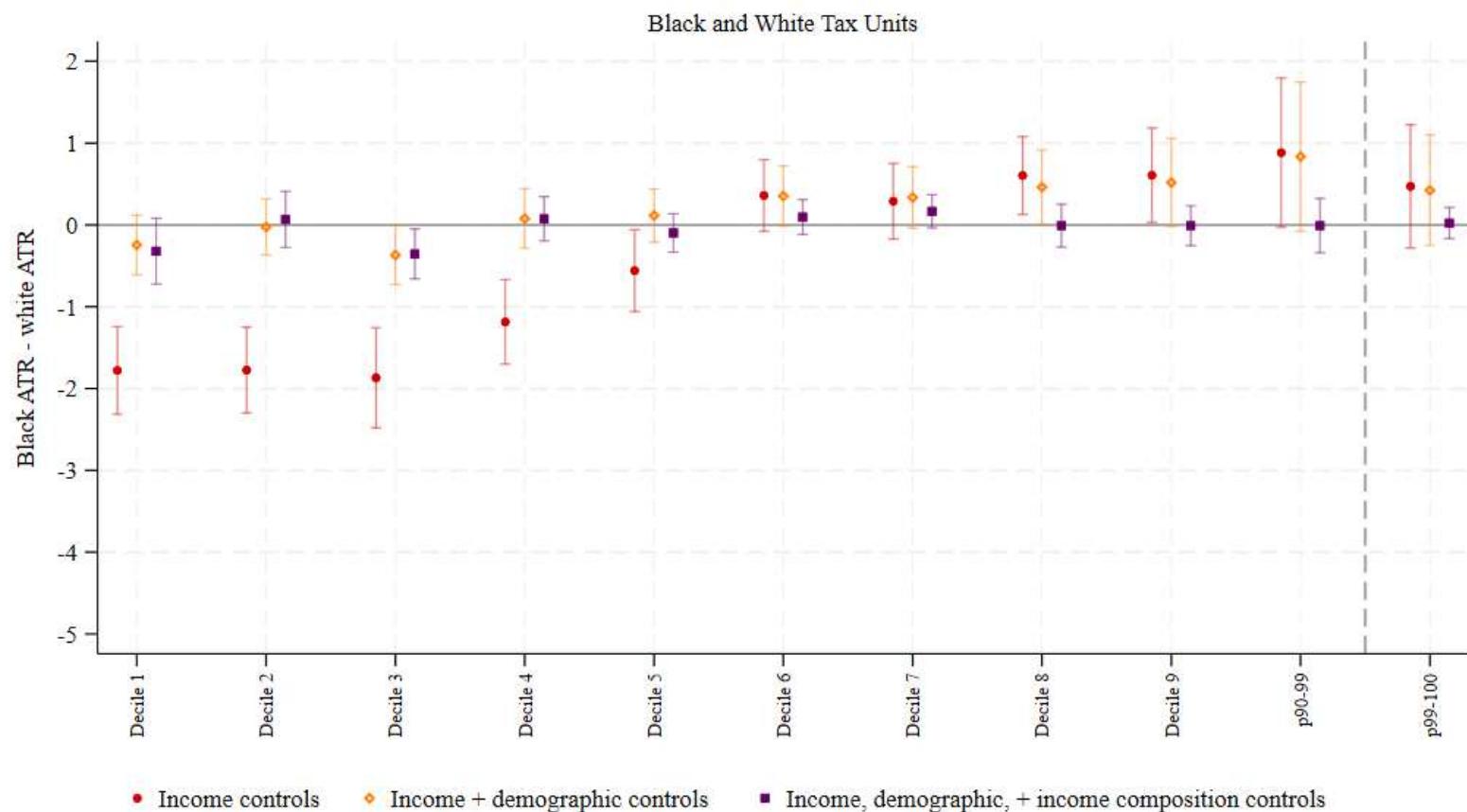
Regressing Tax Burden on Race by EI Decile



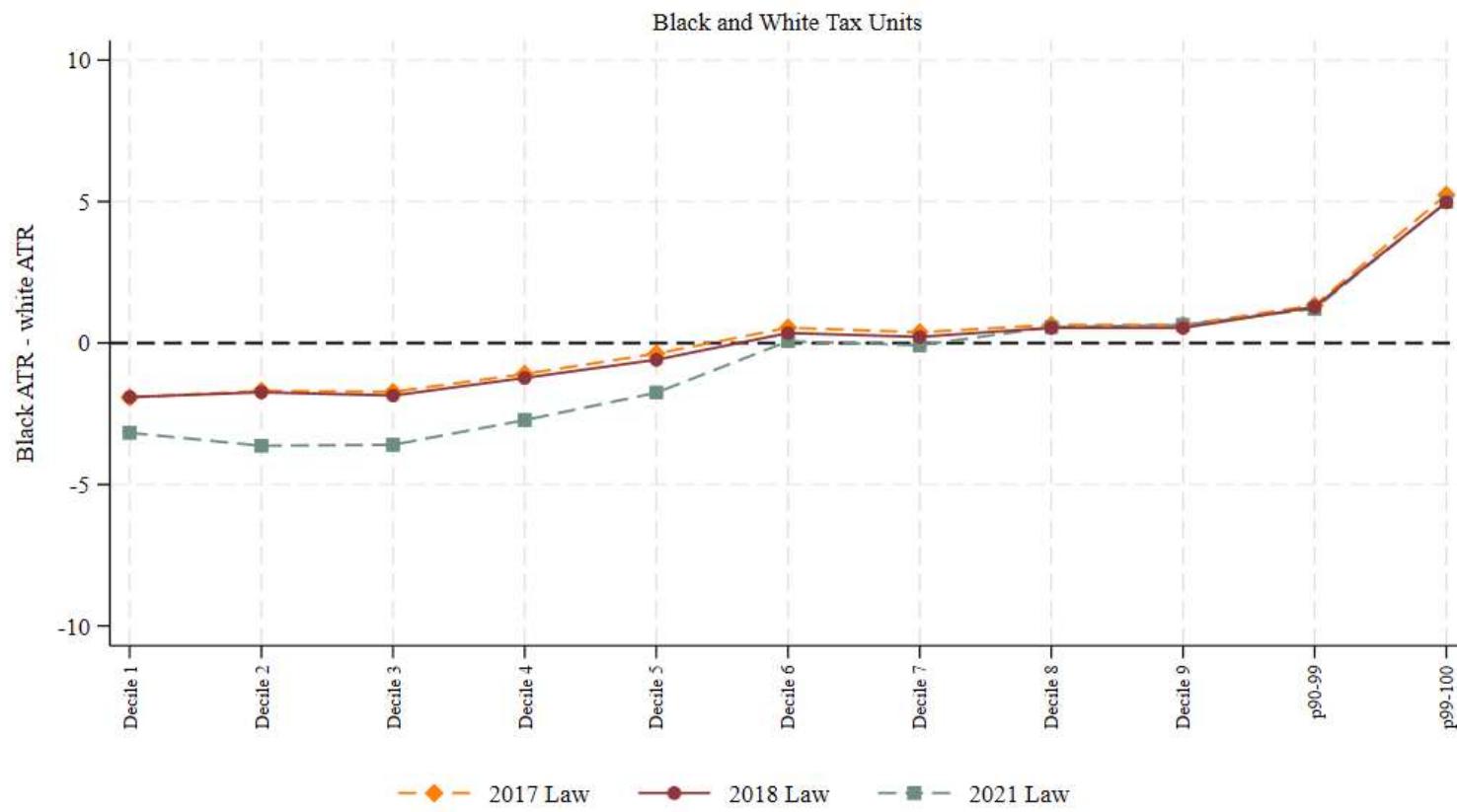
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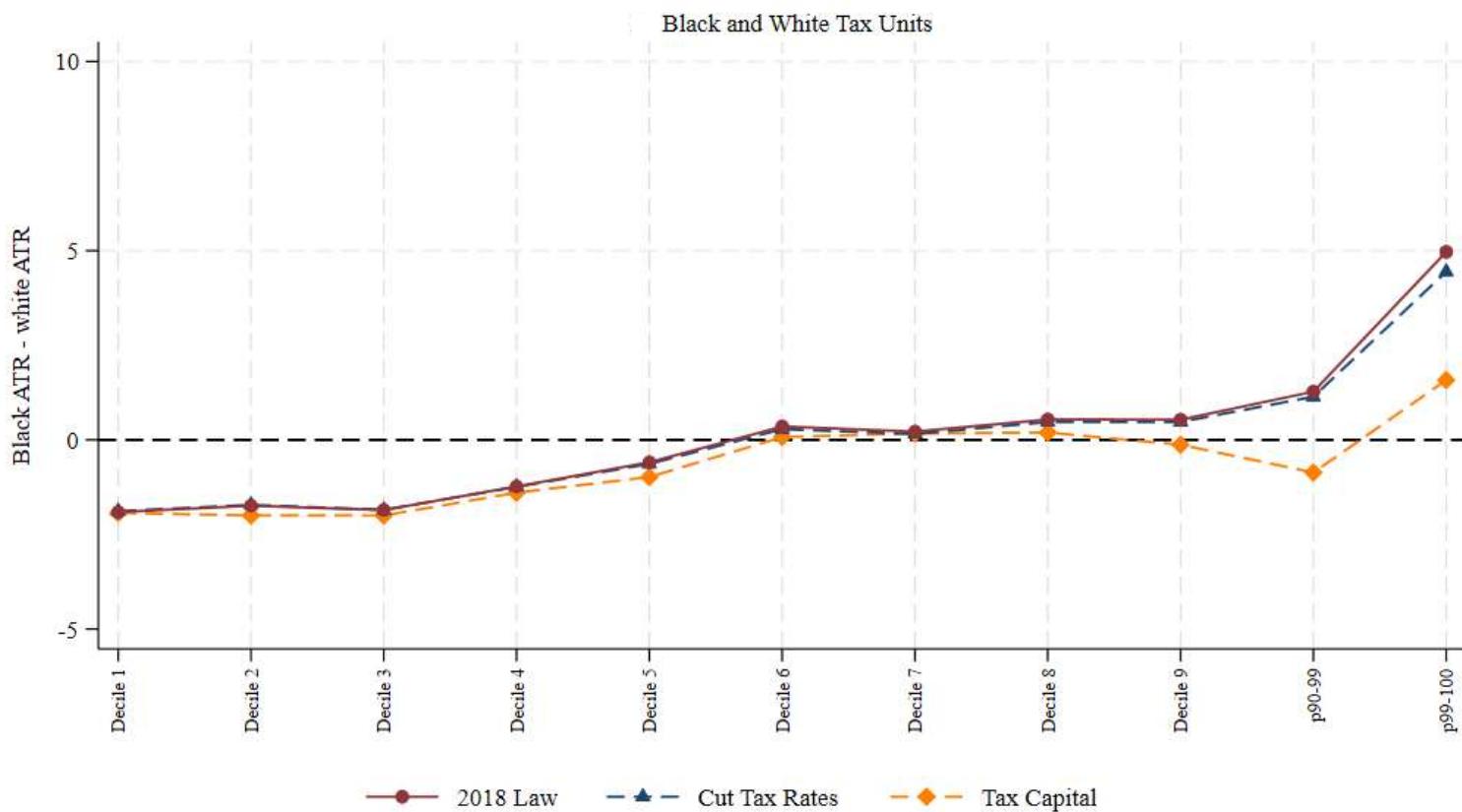
Regressing Tax Burden on Race by EI Decile



Effects of the TCJA and ARP (Income Tax Changes Only)

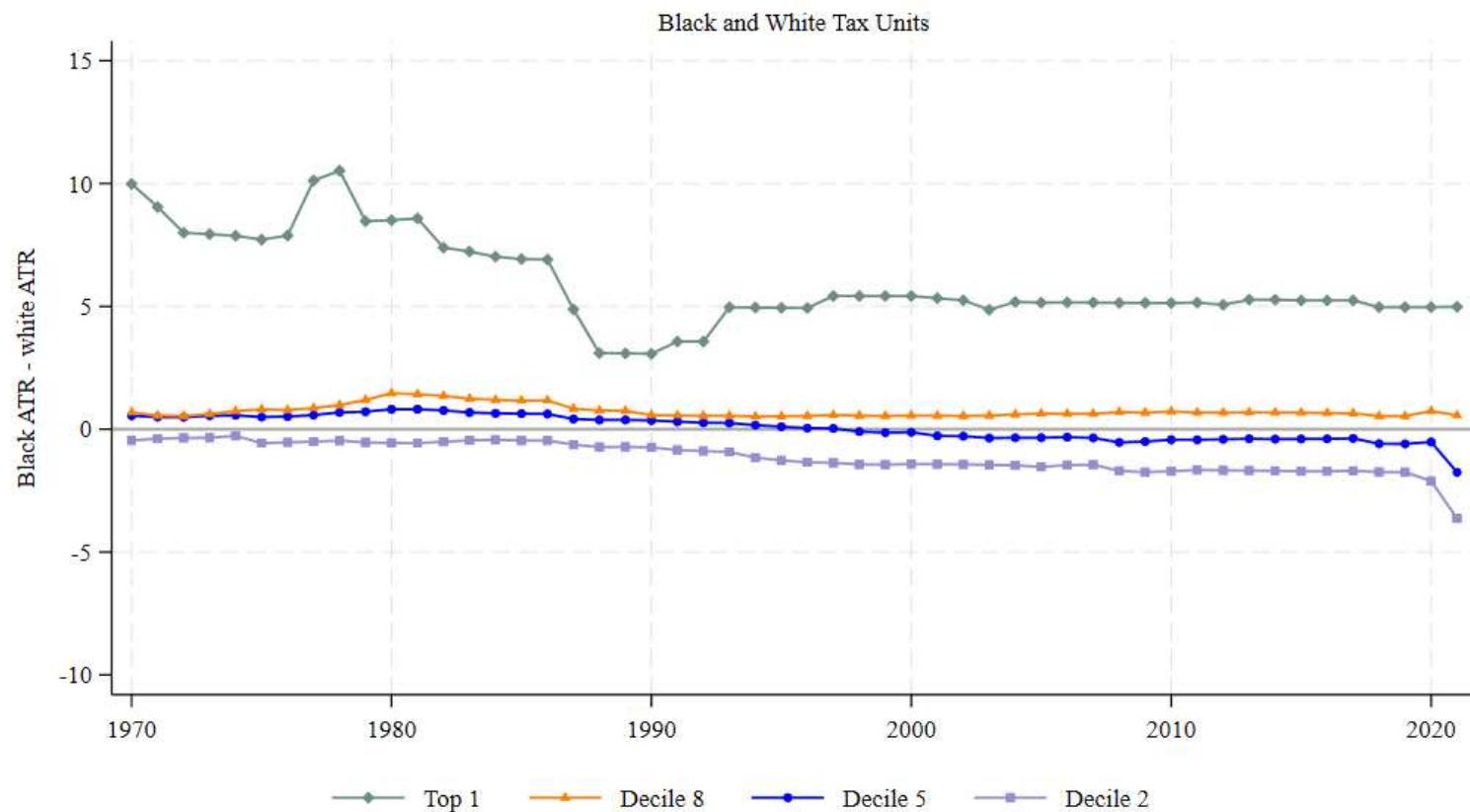


Effects of Broadening the Base by Including More Capital Income



ATRs Under 1970 Law

Replicating Strauss and Gouveia (2023)



Conclusion

- Tax rules can create different outcomes across races even if the code language is race-blind
- Substantial role for policy.
- Racial equity is one more reason to broaden the base by including more capital income
- More work is needed to understand the full dimensions of these issues
 - Other races/ethnicities
 - Other policies – federal and state, spending and regulatory

The Same but Different: How the Income Tax Treats Black, Hispanic, and White Households

<https://www.brookings.edu/articles/the-same-but-different/>