Dēmos

# Taxes Explained: Taxing Income versus Wealth

## U.S. Tax Code Widens the Racial Wealth Divide

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### Key Takeaways

The U.S. tax system privileges wealth accumulation over income earned from work, allowing the ultrarich to exponentially grow their wealth and pass it on without ever paying taxes. Due to our history of systemic racism and discrimination in the public and private sectors, policymakers passed a host of economy policies — from taxes, housing, banking, and credit — that enabled mostly white families to accumulate massive fortunes while excluding others from economic opportunity.[1] As a result, white families hold almost every type of wealth-bearing asset at higher rates than Black and brown families.[2] Our current tax system not only fails to correct and curb this wealth hoarding but actively reinforces it, deepening the racial wealth divide and placing an unfair reliance on middle- and working-class families.

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Today, congressional Republicans and their ultrawealthy allies are preparing to skew the tax code even more in favor of the rich by allowing the ultrawealthy to pass on massive fortunes tax free. Their tax plan would cost the country $4.5 trillion and permanently cut the tax rate for the highest-income households and make permanent the estate tax threshold that allows families to pass down or transfer tens of millions of dollars in wealth without paying taxes.[3] When policymakers make changes that reduce tax revenues significantly, the government must find other revenues or cut spending. Republicans in Congress plan to pay for tax giveaways for those at the very top in part by cutting $2 trillion in funding for public programs that benefit hardworking families.[4]

While the wealthy stand to protect and grow their wealth from these tax cuts, millions of hardworking families will pay the cost, struggling to keep up with rent, put food on the table, and keep the lights on — with nothing left over to invest in their futures.[5] Instead of rigging the system further in favor of the wealthy, policymakers should make the tax code fairer by ending preferential treatment of wealth.

Adequately taxing wealth would not only help curb extreme wealth concentration but also raise revenue that should be invested in public goods that enable everyone, particularly Black and brown people who have been excluded from economic opportunity, a real shot at financial stability and economic mobility.

## Background

### *Why is this relevant right now?*

During his first administration, President Trump and Republican members of Congress cut taxes for wealthy households in a major tax reform bill called the Tax Cuts and Jobs Act (TCJA) that did very little for households with low or moderate incomes.[6] As an example, households in the top 1 percent of earners (with incomes over $3 million) will have an average tax cut of over $60,000 in 2025, according to an analysis from the Tax Policy Center. In contrast, households earning less than $84,000 a year will have, on average, a tax cut of less than $500.[7] Some elements of that bill, including tax cuts for the ultrawealthy, are set to expire at the end of 2025. President Trump and Republicans want to make these tax cuts permanent, skewing the tax code even further to benefit the wealthy.

The TCJA temporarily doubled the estate tax exemption: Before the TCJA, an individual could pass down $5.5 million ($11 million for a couple) to an heir tax free. Starting in 2018, the law allowed a couple to pass down $22 million in wealth without paying taxes.[8] Because the estate tax exemption increases with inflation, a couple can now pass on nearly $28 million tax free to their heirs.[9] That law also temporarily lowered the income tax rate for the highest-income households. Congressional Republicans want to make these provisions permanent or even eliminate the estate tax entirely. Extending these and other provisions from the TCJA will make the rich richer while widening the wealth divide. These extensions would cost the country $466 billion in revenue in 2026, money that should be invested in public goods that benefit everyone, not just the ultrawealthy.[10]

### *How does the U.S. tax regular income and wealth?*

The U.S. tax code privileges wealth over income, effectively taxing income from a paycheck at a higher rate than income earned from wealth. When a worker receives a paycheck, they will pay individual income taxes on the amount they earn from their work. But when someone receives income through wealth – say through capital gains or inherited fortunes – that wealth accumulation is taxed at much lower rates, and in some cases, not at all.[11]

#### *Taxing regular income*

- **Individual income taxes:** The federal individual income tax structure is *progressive*, meaning that higher earners pay a higher percentage of their income in taxes.

- **Payroll taxes:** The federal government also levies payroll taxes, which employers typically withhold from employee paychecks. Revenue from payroll taxes goes toward Social Security, Medicare, and unemployment insurance. While payroll taxes are slightly *regressive,* meaning that taxpayers with low and moderate incomes pay a higher share of their incomes in payroll taxes than higher-income taxpayers, the benefits from Medicare and Social Security are progressive.[12]

### *Taxing wealth*

- **Estate taxes:** The federal estate tax is levied on inherited wealth, including stock, real estate, cash, or other assets. The tax applies only to the portion of the estate that is above the exemption level, which is now $14 million per person (or $28 million for a couple).[13] Only 0.08 percent of estates actually end up paying the estate tax.[14]

- **Capital gains taxes:** "Capital gains" refers to the profit one receives after selling an investment or an asset for a higher price than its original purchase price. The federal government taxes capital gains only when the owner of the capital (e.g., stock shares) sells those investments, and the capital gains tax rates for long-term investments are lower than the rate for ordinary income of the same amount (0 percent, 15 percent, or 20 percent, depending on the taxpayer's income). Because of a tax provision called "step-up in basis," owners of assets that have increased in value can pass on massive investment portfolios to heirs without ever having to pay taxes.[15]

## Impact on Equity

### *A tax code that preferences wealth over income from wages widens the racial wealth divide.*

Policymakers have created a tax code that primarily benefits white households by giving preferential tax treatment to wealth. Generations of policies and practices have excluded Black and brown people from the **opportunity to accumulate wealth** that white people have accessed for centuries.[16] As a result, white taxpayers hold a disproportionate share of wealth in the United States and hold almost every type of wealth-bearing asset at higher rates than Black or brown households.[17] The resulting racial wealth divide is extreme: In 2020, the combined wealth of America's 400 wealthiest billionaires exceeded the total wealth held by all 10 million Black American households.[18]

### *The tax code allows ultrawealthy households to accumulate and pass on their wealth, almost tax free, from generation to generation.*

Some of the most egregious ways that the U.S. tax code helps the rich get richer are through maintaining a weak estate tax, failing to tax capital gains like income, and enabling the wealthy to exploit tax loopholes to hide, protect, and grow their wealth.

- **The federal estate tax** is our tax system's main tool for curbing wealth hoarding and preventing the widening of the already gaping wealth divide, but Congress has weakened it and filled it with loopholes. When Congress doubled the estate tax exemption level in 2017, it exacerbated wealth inequality and gave ultrawealthy households an enormous tax break. The vast majority of these benefits will go to white households: A recent study from the Institute on Taxation and Economic Policy found that 92 percent of wealth owned by families with $30 million or more in net worth is owned by white households.[19] As a result of this change, only about 1,800 of the largest estates are subject to the estate tax.[20] In 2019, only 0.08 percent of people who died left an inheritance large enough to pay an estate tax.[21]

  Now, members of Congress are proposing to make this change permanent or even eliminate the estate tax entirely, which would cost the country $370 billion over 10 years and allow extremely wealthy families to exponentially grow their fortunes without ever contributing to the public good.[22]

- **Preferential treatment of capital gains** almost exclusively benefits white households and is one of the main contributors to wealth concentration. Because capital gains are taxed at lower rates than income from wages, taxpayers with significant investments are able to reliably grow their net worth exponentially faster than those who primarily earn income from wages or salaries. A recent study from the U.S. Treasury Department showed that the average benefit from the preferential tax treatment of capital gains was nine times greater for white families than for Black families in 2023.[23] Put a different way, the U.S. government lost over $146 billion in revenue because it taxes capital gains at lower rates than income. Over 92 percent of that foregone revenue (about $135 billion) would have come from white households.

- Ultrawealthy households are able to use a strategy which some call "**buy, borrow, die**" to benefit from enormous capital gains fortunes and pass them on to their heirs after their death without ever paying taxes. Using this strategy, a wealthy household purchases assets (e.g., stocks, real estate, etc.) and holds onto the investments as they increase in value. Instead of selling these assets, which would trigger a capital gains tax, the holder of those assets can borrow against them and live off of those loans, which are not taxed. When the holder of the asset dies and passes on their fortune, their heirs do not have to pay taxes on the increased value of those assets because the government now considers the current value to be the original, baseline value.[24] The "buy, borrow, die" strategy drives extreme wealth concentration and widens the racial wealth divide.

### *Failing to tax wealth means less revenue to fund public goods*

When the tax code allows wealthy families to dodge taxes through preferential treatments and loopholes, it means there is less revenue to invest in public goods like housing, education, nutrition assistance, and health care. Congressional Republicans recently pushed through a budget resolution that paves the way for $4.5 trillion in tax cuts that will primarily benefit the wealthiest families, including lower-income tax rates for the highest-income earners and a weakened estate tax.[25] They plan to partially offset those tax cuts by slashing funding for programs like Medicaid and the Supplemental Nutrition Program (SNAP), which could leave millions without health coverage or adequate nutrition.

## Policy Recommendations

This is a pivotal moment for tax policy, and we have a duty to fight for a more equitable tax code that adequately taxes wealth and shrinks the racial wealth divide. Instead of further skewing the tax code to benefit ultrawealthy families, the vast majority of whom are white, Congress should advance tax policies that deconcentrate wealth and more equitably distribute the country's resources that broaden the benefits to more taxpayers and our economy. Our tax system needs reform to ensure that wealthy households no longer disproportionately benefit from policies that preference wealth over income from salaries and wages. Adequately taxing wealth will not only help curb wealth hoarding, it will also raise significant revenue. Policymakers must invest that tax revenue in communities to ensure that all people, particularly Black and brown people who have been historically excluded from economic opportunity, can achieve economic security and mobility.

**Congress should advance tax policies that deconcentrate wealth and more equitably distribute the country's resources that broadens the benefits to more taxpayers and our economy.**

Congress can start by making changes to the tax code to end preferential treatment of wealth over income, including the following:

- Strengthen the estate tax by rejecting proposals to extend the TCJA exemption level or to eliminate the estate tax entirely. Congress should significantly lower the estate tax threshold and eliminate loopholes.
- Equalize tax rates on wages and capital gains to prevent the wealthy from paying lower effective tax rates than working people.
- Use revenue from these and other wealth taxes to fund public goods like housing, education, and health care and increase economic opportunities for Black and brown families who face structural barriers to acquiring and growing wealth.

## Endnotes


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## Our Work to Build Power

For decades, Dēmos has been committed to advancing racial justice by working at the intersection of economic justice and democracy reform. Our recent publication, the Dēmos Power Agenda: A Framework for Building People Power, outlines our vision for creating a just, inclusive, multiracial democracy and economy. The Power Scorecard offers a data framework and tool to establish a baseline of the current economic, civic, and political conditions we face as we fight for that multiracial democracy and economy.

## About Dēmos

Dēmos is a non-profit public policy organization working to build a just, inclusive, multiracial democracy and economy. We work hand in hand to build power with and for Black and brown communities, forging strategic alliances with grassroots and state-based organizations.

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