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Dorothy A. Brown

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RACIAL EQUALITY IN THE TWENTY-FIRST CENTURY: WHAT'S TAX POLICY GOT TO DO WITH IT?

*Dorothy A. Brown**

"[T]ax . . . statutes . . . may be more burdensome to the poor and to the average black than to the more affluent white."¹

In 1976, Supreme Court Justice Byron White recognized that tax statutes may have a disparate impact based upon race.² Yet, it has taken the legal academy until the 1990's to begin to address those issues,³ and given the recent spate of attacks, many still are unwilling to accept the proposition.⁴

I. BACKGROUND

I first began thinking about these issues after reading Professor Jerome Culp's article *Toward a Black Legal Scholarship: Race and Original Understandings*.⁵ That thinking has resulted in several articles⁶ in which I

* Professor, University of Cincinnati College of Law, Cincinnati, Ohio. B.S. 1980, Fordham University; J.D. 1983, Georgetown University Law Center; L.L.M. 1984, New York University. First I would like to thank Dean Smith for the opportunity to participate in the Alzheimer Symposium on Racial Equity in the 21st Century. I would like to thank Professors Karen Brown, Karen Burke, Mary Louise Fellows, Donna Nagy, Wendy Parker, John Powell, and Michael Solimine for helpful comments. I would also like to thank the participants at the University of Cincinnati College of Law Faculty Workshop. I would especially like to thank Ms. Laura McKinley and Mr. Mark Dinkelacker for excellent research assistance.

1. See *Washington v. Davis*, 426 U.S. 229, 248 (1976).

2. See *id.*

3. See Mary Louise Fellows, *Rocking the Tax Code (A Case Study of Employment-Related Child Care Expenditures)*, 10 *YALE J.L. & FEMINISM* 307 (1998); Karen B. Brown, *Not Color-or-Gender-Neutral: New Tax Treatment of Employment Discrimination Damages*, 7 *REV. L. & WOMEN'S STUD.* 223 (1998); Dorothy A. Brown, *The Marriage Bonus/Penalty in Black and White*, in *TAXING AMERICA* 45 (Karen B. Brown & Mary Louise Fellows eds., 1996). See also Dorothy A. Brown, *Race, Class, and Gender Essentialism in Tax Literature: The Joint Return*, 54 *WASH. & LEE L. REV.* 1469 (1997); Dorothy A. Brown, *Split Personalities: Tax Law and Critical Race Theory*, 19 *W. NEW ENG. L. REV.* 89 (1997); Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 *WIS. L. REV.* 751.

4. See Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 *N.C. L. REV.* 1521, 1526 (1998) ("I am less convinced of the merits of the critical race tax project, although it is too early to dismiss the approach."); James D. Bryce, *A Critical Evaluation of the Tax Critics*, 76 *N.C. L. REV.* 1687 (1998) ("Recent years have seen the spread of legal academia's favorite obsession—sex and race as the origin of all of society's ills—to the tax law. In my view, this is not a helpful development." (footnotes omitted)); Charles O. Galvin, *Taking Critical Tax Theory Seriously—A Comment*, 76 *N.C. L. REV.* 1749, 1752 (1998) ("Like Professor Zelenak, I find the critical race theorists' criticisms unconvincing.").

5. See Jerome McCristal Culp, Jr., *Toward a Black Legal Scholarship: Race and Original Understandings*, 1991 *DUKE L.J.* 39.

6. See Brown, *The Marriage Bonus/Penalty*, *supra* note 3; Brown, *Race, Class, and*

have examined Census Bureau data, among others, as a proxy for taxable household income, because the Internal Revenue Service does not collect taxpayer data by race.⁷ My previous research shows that in one area, namely the joint return provisions of the Internal Revenue Code, taxpayers bear the costs of those provisions differently based upon their race.⁸ Blacks pay a higher tax as a result of getting married than do whites ("the marriage penalty") and whites pay less in taxes as a result of getting married than do blacks ("the marriage bonus").⁹ My previous research shows that black married couples disproportionately pay the marriage penalty and white couples, particularly upper-income white couples, disproportionately receive a marriage bonus.¹⁰

You may ask how this is possible given that the Internal Revenue Code is race-neutral on its face. There is nothing in the Code that explicitly says blacks pay more, whites pay less. This is still America—isn't it? I submit, because this is America, one could intuitively expect to observe racial disparities in the implementation of our federal tax laws, which date back to the Sixteenth Amendment and the Revenue Act of 1913.¹¹

The marriage penalty hits the hardest where husbands and wives contribute roughly equal amounts to total household income.¹² The marriage bonus is the greatest when only one spouse is contributing to total household income by working in the paid labor market.¹³ When you examine the households in the Census Bureau sample, black households were most likely to have co-equal wage earners and white households were most likely to have sole wage earners.¹⁴

Gender Essentialism, *supra* note 3; Dorothy A. Brown, *Split Personalities*, *supra* note 3; Brown, *The Marriage Bonus/Penalty: Legislative Solutions in Black and White*, N.Y. L. SCH. J. HUM. RTS. (forthcoming 1999).

7. See Brown, *Split Personalities*, *supra* note 3, at 91; Brown, *The Marriage Bonus/Penalty*, *supra* note 3, at 49; Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at n.147.

8. See Brown, *Split Personalities*, *supra* note 3, at 93; Brown, *The Marriage Bonus/Penalty*, *supra* note 3, at 49-50; Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1498-1507.

9. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1498-1507.

10. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1498-1504.

11. Cf. DERRICK BELL, *FACES AT THE BOTTOM OF THE WELL: THE PERMANENCE OF RACISM* 12 (1992) ("Black people will never gain full equality in this country. Even those herculean efforts we hail as successful will produce no more than temporary 'peaks of progress,' short-lived victories that slide into irrelevance as racial patterns adapt in ways that maintain white dominance. This is a hard-to-accept fact that all history verifies.")

12. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1479.

13. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1479.

14. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1499-1504.

Table 1.1¹⁵

AFRICAN-AMERICAN HOUSEHOLD INCOME ALLOCATION BETWEEN HUSBAND AND WIFE					
Income Levels	100%/0%	90%/10%	80%/20%	70%/30%	60%/40%
	90%/10%	80%/20%	70%/30%	60%/40%	50%/50%
\$0 to 10,000	84.06%	3.60%	3.70%	3.57%	5.06%
\$10,001 to 20,000	63.25%	7.32%	8.02%	8.76%	12.65%
\$20,001 to 30,000	38.81%	7.75%	12.20%	16.13%	25.11%
\$30,001 to 40,000	26.07%	7.76%	12.94%	20.08%	33.16%
\$40,001 to 50,000	15.42%	6.87%	13.70%	25.68%	38.33%
\$50,001 to 60,000	9.22%	6.13%	14.00%	27.45%	43.21%
\$60,001 to 70,000	6.37%	4.57%	14.13%	28.17%	46.76%
\$70,001 to 80,000	6.59%	4.21%	11.73%	28.23%	49.23%
\$80,001 to 90,000	5.88%	3.81%	14.62%	26.17%	49.53%
\$90,001 to 100,000	6.55%	7.52%	14.90%	26.88%	44.15%
\$100,001 to 120,000	9.24%	7.60%	18.35%	28.66%	36.15%
\$120,001 & over	37.40%	14.54%	14.12%	11.98%	21.96%

This table shows at the \$20,000 and under income level, African-Americans are most likely to be in single wage earner households. Between \$30,001 and \$120,000 household income levels, African-Americans are most likely to be in dual wage-earning marriage penalty households. At \$120,001 and higher household income African-Americans are more likely to be in

15. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1504 (reprinted with permission of the publisher). (Excluded from the discussion in this article are the severe marriage penalties imposed by the earned income tax credit.) See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1479-1481.

marriage bonus households. As a result, the greatest percentages of African-American households are marriage penalty households.

Table 1.2¹⁶

WHITE HOUSEHOLD INCOME ALLOCATION BETWEEN HUSBAND AND WIFE					
Income Levels	Contribution Percentages				
	100%/0%	90%/10%	80%/20%	70%/30%	60%/40%
	- 90%/10%	- 80%/20%	- 70%/30%	- 60%/40%	- 50%/50%
\$0 to 10,000	87.49%	2.85%	2.89%	2.80%	3.97%
\$10,001 to 20,000	69.11%	6.88%	7.18%	7.26%	9.58%
\$20,001 to 30,000	53.21%	9.27%	10.87%	11.47%	15.18%
\$30,001 to 40,000	41.63%	10.77%	12.79%	15.43%	19.38%
\$40,001 to 50,000	32.87%	10.86%	14.39%	18.55%	23.33%
\$50,001 to 60,000	27.00%	10.63%	14.77%	20.88%	26.72%
\$60,001 to 70,000	24.15%	9.80%	16.44%	21.44%	28.17%
\$70,001 to 80,000	26.06%	9.27%	14.63%	22.25%	27.79%
\$80,001 to 90,000	26.54%	10.27%	15.98%	20.04%	27.17%
\$90,001 to 100,000	35.98%	9.78%	14.52%	16.74%	22.97%
\$100,001 to 120,000	36.61%	12.57%	15.17%	16.17%	19.48%
\$120,001 & over	58.88%	13.07%	10.47%	7.70%	9.42%

16. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3, at 1505 (reprinted with permission of the publisher).

White households up to \$60,000 are more likely to be in single wage earner households, and once over \$30,000 household income, most likely to receive a marriage bonus. Interestingly enough middle income white households in the \$60,000-90,000 income levels were most likely to pay a marriage penalty. For households earning over \$90,000 more whites receive the marriage bonus than pay the marriage penalty.

Total household income is a result of wages earned in the paid labor market. One reason that black couples contribute roughly half of household income and white couples are more likely to be in sole wage earner households is a function of race discrimination in the paid labor market.¹⁷ It is those issues that the balance of this article will address.

II. CURRENT TAX POLICY AND RACE DISCRIMINATION IN THE LABOR MARKET

My charge, from Dean Smith, was to suggest a change in the Internal Revenue Code that would work toward the goal of achieving racial equity in the twenty-first century. I believe there is no greater culprit that prevents the achievement of racial equality in this country than the systemic racism found throughout the paid labor market.¹⁸ My proposal therefore will be to use the federal tax laws to disrupt the wage discrimination faced by workers of color.

I would like to begin by giving you some background statistical information that I suspect is all too familiar. For 1995, the Census Bureau reported median weekly earnings for white males, of \$566, for black males \$411, for black females \$355, for Hispanic males \$350, for Hispanic females \$305.¹⁹ The unemployment rate for whites was 4.9% for 1995, for blacks was 10.4%, for Hispanics 9.3%.²⁰

17. When I refer to race discrimination in the paid labor market, I am referring only to the disparate wages earned based upon race. *Cf.* U.S. COMMISSION ON CIVIL RIGHTS, *THE ECONOMIC STATUS OF BLACK WOMEN: AN EXPLORATORY INVESTIGATION* (1990) ("Many factors . . . combine to lower black women's economic status . . . [including] the relatively lower incomes of other family members, especially the lower labor market earnings of their husbands . . . Racial discrimination in the labor market may depress black women's wages and occupational status, increase their unemployment rates, and indirectly lower their labor force participation rates.").

18. *See* ONE AMERICA IN THE 21ST CENTURY: FORGING A NEW FUTURE 67 (1998) "[S]ignificant disparity remains between the earnings capacity, economic propensity, and wealth of whites and most minority groups."

19. *See* Brown, *Not Color-or-Gender-Neutral*, *supra* note 3, at 224-225 (citing BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE STATISTICAL ABSTRACT OF THE UNITED STATES: 1996). The Bureau of Labor Statistics does not currently tabulate monthly and annual average data separately for Asian-Americans. *See* E-mail from Francis Horvath, Office of Employment and Unemployment Statistics, Bureau of Labor Statistics (Mar. 29, 1999).

20. *See* Brown, *Not Color-or-Gender-Neutral*, *supra* note 3, at 224-25.

Class action lawsuits alleging job discrimination more than doubled between 1993 and 1997.²¹ A July 1998 *New York Times* article reveals that under welfare reform for the first time in the history of our country, there will be more minorities on welfare than whites because employers are preferring to hire white welfare recipients over welfare recipients of color.²²

Employment discrimination, while an evil in its own right, leads to more serious consequences.²³ Wealth has been described as "one indicator of material disparity that captures the historical legacy of low wages, personal and organizational discrimination, and institutionalized racism. One road to wealth is long-term steady employment in the kinds of work organizations that offer job-sponsored benefits and retirement packages."²⁴ Similarly, the lack of those employment opportunities over the long-term "result[s] in less savings, less investments, and less transfers to succeeding generations. Over time, less income can result in vast differences in asset accumulation."²⁵

In 1993, white households had median measured net worth of \$45,740 while black households had median measured net worth of \$4,418.²⁶ In the highest income level, the median net worth of whites was \$123,350 and of blacks was \$45,023.²⁷ In the lowest income level, the median net worth of whites was \$7,605, compared with \$250 for blacks.²⁸

How do the federal tax laws exacerbate societal racism that is reflected in the paid labor market? This section will describe the tax treatment of deductions under Section 162 of the Internal Revenue Code. With limited exceptions, employers can deduct all wages under Internal Revenue Code Section 162(a)(1) provided they are ordinary, necessary, reasonable, for services rendered, and incurred in a trade or business.²⁹

Second, although the Supreme Court in 1958 announced a "public policy" limitation on deductions under Section 162 of the Internal Revenue Code, "if allowance of the deduction would frustrate sharply defined national

21. See Brown, *Not Color-or-Gender-Neutral*, *supra* note 3, at 225.

22. See Jason DeParle, *Shrinking Welfare Rolls Leave Record High Share of Minorities: Fast Exodus of Whites Alters the Racial Balance*, N.Y. TIMES, July 27, 1998, at A1.

23. See Regina Austin, *Nest Eggs and Stormy Weather: Law, Culture, and Black Women's Lack of Wealth*, 65 U. CIN. L. REV. 767, 773-775 (1997).

24. See MELVIN OLIVER & THOMAS SHAPIRO, *BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY* 112 (1995).

25. See MICHAEL SHERRADEN, *ASSETS AND THE POOR WELFARE POLICY: A NEW AMERICAN* 131 (1991). As professor Cruz Reynoso has so eloquently reminded us in his Keynote Address, the term "assets" has great significance. Assets is defined as "that which enhances strength."

26. See Austin, *supra* note 23, at 769.

27. See Austin, *supra* note 23, at 769.

28. See Austin, *supra* note 23, at 769.

29. See I.R.C. § 162 (a)(1) (amended 1986).

or state policies . . . evidenced by some governmental declaration thereof,"³⁰ Congress limited the instances in which courts could apply the public policy doctrine.³¹ The 1969 Congressional amendments limited the applicability of the public policy doctrine to the following: (i) a certain portion of punitive damages in antitrust awards;³² (ii) of fines or penalties paid to a government for the violation of any law;³³ (iii) or for illegal bribes or kickbacks.³⁴ Further, Treasury Regulations under Section 162 provide that "[a] deduction for an expense . . . which would otherwise be allowable under section 162 shall not be denied on the grounds that allowance of such deduction would frustrate a sharply defined public policy."³⁵ Therefore, it is well settled that courts are unable to apply the public policy doctrine to any situation not already proscribed by Congress in Section 162.

Third, it is generally accepted that employment discrimination awards are deductible by the discriminator under Section 162, regardless of whether the damage awards are compensatory or punitive.³⁶

With respect to the income side, the recipient of employment discrimination awards are held to have received taxable income regardless of whether the damage awards are compensatory or punitive.³⁷ Further, wages received by employees who were discriminated against on the basis of race, will constitute taxable income.³⁸ Discriminators can deduct their wage expenses and the discriminated against are taxed upon those wages.

Well, what does this all mean and what changes would I make to federal tax law? What this means is that the federal government by allowing deductions for wages paid in a racially discriminatory manner and allowing

30. See *Tank Truck Rentals v. United States*, 356 U.S. 30, 33-34 (1958).

31. Tax Reform Act of 1969, Pub. L. No. 91-172, § 902, 83 Stat. 487, 710-11 (codified as amended at I.R.C. § 162).

32. See I.R.C. § 162(g).

33. See I.R.C. § 162(f); See also F. Philip Manns, Jr., *Internal Revenue Code Section 162(f): When Does the Payment of Damages to a Government Punish the Payor*, 13 VA. TAX REV. 271 (1993).

34. See I.R.C. § 162(c)(2).

35. Treas. Reg. § 1.162-1(a). See also SENATE COMM. ON FIN., TAX REFORM ACT OF 1969, S. REP. NO. 552, 91st CONG. 1st SESS. 273, reprinted in 1969 U.S.C.A.N. 2027, 2310 ("The provision for the denial of the deduction for payments [of fines or similar penalties; of a portion of treble damages, and of bribes or kickbacks] which are deemed to violate public policy is intended to be all inclusive."). See also Kimberly A. Pace, *The Tax Deductibility of Punitive Damage Payments: Who Should Ultimately Bear the Burden for Corporate Misconduct*, 47 ALA. L. REV. 825, 834 (1996).

36. See Rev. Rul. 80-211, 1980-2 C.B. 57 (holding punitive damages deductible); See also Rev. Rul. 69-581, 1969-2 CB 25 (holding compensatory damages deductible).

37. See I.R.C. § 104(a)(2); See also Brown, *Not Color-or Gender-Neutral*, supra note 3, at 243-244.

38. See I.R.C. § 61.

deductions for actual damage awards, is subsidizing the race discriminator. By taxing the award to the recipient the federal government is adding insult to injury. If we lived in a society truly committed to racial equality, our current tax law policies in this area would change.

III. REVAMPING THE FEDERAL TAX LAWS TO DISCOURAGE LABOR FORCE DISCRIMINATION

How would I change the Internal Revenue Code to discourage employers from discriminating on the basis of race? First, I would prohibit the deduction by employers for the punitive and/or compensatory damage awards made in race discrimination cases.³⁹ Second, I would enact the proposal of Professor Karen Brown of George Washington University "to exclude from taxation all components of job bias awards" from the income of the person who has been discriminated against.⁴⁰ Third, I would prohibit the deduction by employers of wages for *ALL* workers whenever the employer lost a race-based employment discrimination lawsuit or settled a race-based employment discrimination lawsuit, with respect to any of its workers. Fourth, and finally, I would exclude from income the wages received by employees who were discriminated against on the basis of race.⁴¹

I would define race discrimination to include all instances where damages were paid pursuant to a judgment against an employer who was found to have discriminated against an employee on the basis of race as well as damages paid in settlement of a lawsuit.⁴² We must remember that federal

39. I note that this proposal is equally applicable to other forms of labor market discrimination including gender, sexual orientation, and disability. My proposal is limited to race because of the nature of this symposium.

40. See Brown, *Not Color-or-Gender-Neutral*, *supra* note 3, at 266. See also Mary L. Heen, *An Alternative Approach to the Taxation of Employment Discrimination Recoveries Under Federal Civil Rights Statutes: Income from Human Capital, Realization, and Nonrecognition*, 72 N.C. L. REV. 549, 554 ("[E]mployment discrimination recoveries such as back pay and front pay should be excluded from income. . . . Punitive damages, on the other hand, serve noncompensatory functions such as deterrence and retribution. Punitive damages should therefore be included in income." (footnotes omitted)).

41. Cf. A-Corps proposal designed to provide tax benefits to corporations willing to provide certain employment benefits including training, education, health care and profit-sharing to its workforce. 2/29/96 DAILY TAX REP. 7.

42. I recognize there are those who argue against employment discrimination laws as unnecessary to eradicate race discrimination due to free market principles and would understandably oppose my proposals. See, e.g., GARY BECKER, *THE ECONOMICS OF DISCRIMINATION* (2d ed. 1971); Richard Posner, *The Efficiency and Efficacy of Title VII*, 136 U. PA. L. REV. 517 (1987); RICHARD EPSTEIN, *FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS* (1992). I, however, tend to side with those who agree with the existence of employment discrimination laws as a means of curbing discriminatory behavior. See, e.g. Cass Sunstein, *Lochner's Legacy*, 87 COLUM. L. REV. 873 (1987); Cass

tax laws are widely believed to encourage behavior through allowing deductions and credits and discourage behavior by denying deductions, or imposing penalties.⁴³ Why shouldn't federal tax laws be designed to discourage race based employment discrimination? For as long as we have had federal tax laws they have subsidized race discriminators by allowing them complete deductions.

When Congress codified the public purpose doctrine in 1969, it observed that to allow certain deductions would frustrate sharply defined national or state policies.⁴⁴ As a result, the public policy doctrine was enacted to prevent a tax deduction from reducing the "sting" of a penalty intended to punish the wrongdoer.⁴⁵ Similarly here, denying wage deductions to employers who discriminate on the basis of race as well as denying the deduction for the judgment or settlement amount will penalize the employer. By denying the deductions, the "sting" of the penalty will not be reduced. The race discriminator will be punished in civil court and will be punished again through the operation of the federal tax laws. If eliminating discrimination on the basis of race is a clearly defined national policy, this proposal must be adopted.

All other similarly situated employers who do not discriminate on the basis of race will be able to take wage deductions. To the extent the company were publicly held, one might expect shareholders to sell shares in Company A, a race discriminator, not allowed to deduct wages and instead to purchase stock in Company B, a non-race discriminator, allowed to deduct wages paid to their employees. The race discriminator becomes an economic outcast and must change practices if they are to continue operating competitively.

With respect to the employees who receive damage awards or settle lawsuits alleging race discrimination, those awards should be excluded from taxable income in order to compensate the victims for the harms suffered. The exclusion should provide an additional incentive to the employees to file suit against their employers. In addition wages paid while the taxpayer was being discriminated against should also be excluded for similar reasons. Assuming most of their taxable income comes from wages, and withholding taxes were

Sunstein, *Why Markets Don't Stop Discrimination*, 8 SOC. PHIL. & POL'Y 22 (1991); Judith Olans Brown et al., *Some Thoughts About Social Perception and Employment Discrimination Law: A Modest Proposal for Reopening the Judicial Dialogue*, 46 EMORY L.J. 1487 (1997); John J. Donohue III, *Is Title VII Efficient?*, 134 U. PA. L. REV. 1411 (1986); John J. Donohue III, *Further Thoughts on Employment Discrimination Legislation: A Reply to Judge Posner*, 136 U. PA. L. REV. 523 (1987); John J. Donohue III & Peter Siegelman, *The Changing Nature of Employment Discrimination Litigation*, 43 STAN. L. REV. 983 (1991).

43. See Brown, *Race, Class, and Gender Essentialism*, *supra* note 3 at 1484 ("There is, however, widespread support for the proposition that taxes influence behavior." (footnote omitted)).

44. See *Tank Truck Rentals*, 356 U.S. at 33-34.

45. See *id.*

deducted, they should receive a refund of all taxes withheld for the years in question. In order for the pervasiveness of racism to be eliminated, it must be fought on several fronts.

This proposal seeks to move the employment playing field from an overwhelmingly white, male field, to a more inclusive one.⁴⁶ Who would my proposal not affect? Non-profits and governmental agencies because they are not motivated by tax considerations. I leave, for another day, solutions to address those entities.

If my proposals were enacted, one would expect to see a significant diminishing of race based employment discrimination. People of color would earn as much as whites. We would expect to see wealth in households of color increase over time. We might even see more families of color in marriage bonus households, because either wives or husbands of color would earn sufficient amounts to become the sole wage earner.

IV. CONCLUSION

Although the federal tax laws did not cause societal racism, they are operating to exacerbate that racism by permitting employers who discriminate on the basis of race to deduct their discriminatory damage awards as well as deducting their discriminatory wages.⁴⁷ The federal tax laws' role in reinforcing societal racism must be explored, written about, challenged and ultimately eliminated.

46. Cf. FEDERAL CLASS CEILING COMM'N, GOOD FOR BUSINESS: MAKING FULL USE OF THE NATION'S HUMAN CAPITAL iii-iv ("At the highest levels of business, there is indeed a barrier only rarely penetrated by women or persons of color. Consider: 97% of the senior managers of Fortune 1000 industrial and Fortune 500 companies are white; 95% to 97% are male.").

47. See TAXING AMERICA 2 (Karen B. Brown & Mary Louise Fellows eds., 1996) ("What is missing from both the political and the academic debate about taxes is a serious consideration of how the tax system exacerbates marketplace discrimination against traditionally subordinated groups.").