

Testimony of

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Americans

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I would like to thank Chair Moore, Vice-Chair Brown and each member of the Task Force for inviting me to share my views with you today. I want to begin by thanking you for including a discussion of tax policy considerations into your deliberations because they are certainly relevant to any discussion about reparations.

My book, *The Whiteness of Wealth*¹ showed the various ways that our federal income tax system disadvantages black Americans, while at the same time advantaging white Americans. Whether black Americans are getting married, owning a home, paying for college, working, or simply trying to build intergenerational wealth, our tax laws as written have a racially disparate impact.² Black Americans are less likely to gain access to the tax breaks that their white peers receive and therefore are more likely to pay higher taxes than their white peers. My ideal solution was to argue for a reparations tax credit designed to compensate black taxpayers for their decades of paying higher taxes. As I describe in the book, such a tax credit, however, would be unlikely to prevail against a federal constitutional challenge given the lack of proof that

¹ Dorothy A. Brown, *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans- And How We Can Fix It*, (Crown) 2021.

² Many of my findings have been confirmed in a recent report issued by the Treasury Department. Cronin, DeFilippes, and Fisher, *Tax Expenditures by Race and Hispanic Ethnicity: An Application of the U.S. Treasury Department's Race and Hispanic Ethnicity Imputation* (Office of Tax Analysis, Working Paper 122, January 2023).

Congress enacted specific tax provisions with the specific intent to discriminate against black Americans. I argue as a second-best alternative, a wealth tax credit applicable to all taxpayers in households with below median wealth. Given the racial wealth disparity, this will result in a disproportionate percentage of black households receiving the credit, but will be available to taxpayers regardless of race or ethnicity thereby passing the test for constitutionality.

Lack of intent, however, is no bar when it comes to a discussion of reparations. Slavery was an intentional system designed to exploit, subjugate, and dehumanize African Americans. As described in the Task Force’s Interim Report: “Although the U.S. constitution recognized African Americans as citizens on paper, the government failed to give them the full rights of citizenship, and failed to protect—and often sanctioned or directly participated—African Americans from widespread terror and violence.”³ (citations omitted)

So when discussing reparations and considering monetary and/or non-monetary options, there are two key goals as I see it from a tax perspective. First, you need to ensure the reparations paid are not treated as taxable income to the recipients. Second, it is important that African Americans are not paying for their own reparations which means the source of funding needs to be carefully considered. From a non-tax perspective, one issue that you may also want to consider is whether you should prevent any pre-existing state obligations (child support, back taxes, etc) owed by the reparations recipient to be used to offset any reparations payments. For example, the recent COVID economic impact payments were protected from all offsets other than state child support offsets. There is a strong argument to be made that reparations should be protected from *all* offsets.⁴ Reparations are by design, an attempt to make whole that which a

³ Interim Report, Task Force, At 5

⁴ If for example, the reparations payment was a direct deposit, once the money was deposited into the account garnishments could attach from non-state creditors. The State of California therefore might consider whether it is possible to against that in order to protect recipients and preserve the intent behind direct reparations payments.

racist system broke. To allow offsets means that money will not only not reach those it was intended to benefit, but could reach those who are complicit in the systemic racism which gave rise to the need for reparations.

I want to be clear that I am not providing tax advice or guidance but providing a possible analysis of any reparations payments. I leave it to your tax counsel to make a final determination that you would rely upon moving forward.

Reparations Should Be Received Tax-Free

The first goal is to make sure that any payments would be excluded from the recipient's gross income and would therefore not be taxable. There is precedent for reparations payments being excluded from federal taxable income. In 1956, the Internal Revenue Service ("IRS") issued Revenue Ruling 56-518⁵ which determined the tax treatment of payments received by U. S. citizens who were formerly German citizens and "were persecuted...and thereby suffered damage to life, body, health, liberty, rights of property ownership, or to professional or economic advancement." The IRS found that "the compensation paid ...are in the nature of reimbursement for the deprivation of civil or personal rights and do not constitute taxable income to the recipients for Federal income tax purposes." The IRS also found that "where the right of property ownership is involved, payments which are measured by the value of property taken from persecuted taxpayers do not in any event constitute taxable income where the taxpayer has not recovered his basis."

In other words, cash received will be received tax-free and if a payment is received regarding property, the payment will be received tax-free at least to the extent the recipient paid to purchase the property. So if a taxpayer paid \$10,000 for a piece of property that was stolen or

⁵ Rev. Rul. 56-518, 1956-2 C.B. 25

confiscated by Germany, and that taxpayer received \$8,000 in connection with the property as reparations, the \$8,000 would be received tax-free because the taxpayer had spent \$10,000 in total to purchase the property. Only if the taxpayer received more than \$10,000 in reparations regarding the property would an issue be raised as to whether any amount received would be taxable, and the IRS said in that case “the question whether the excess represents taxable income will be determined on the basis of the facts and circumstances of each case.”

This tax-free treatment of Holocaust payments was made permanent in the Economic Growth and Tax Relief Reconciliation Act of 2001.⁶ Both the amount of the Holocaust restitution payments, and the documentation required to prove eligibility for such exclusion, are omitted from tax forms altogether so there is no additional paperwork required to show proof of eligibility.⁷ This approach seems consistent with the underlying goal of the payments. That is, the payment should be excluded from the recipient’s income because the payments are designed to make them whole rather than viewed as an accrual of new wealth. Finally, there would ideally be no third-party reporting (like a 1099 information return) so taxpayers will not be flagged by the IRS as having income.

The tax-free treatment of reparations paid to Holocaust survivors were extended to Japanese Americans. Surviving Japanese Americans received \$20,000 of reparations as a result of their mass incarceration during World War II. In the legislation that authorized the reparations payments, a provision was included that provided: “Amounts paid to an eligible individual under this section – (1) shall be treated for purposes of the internal revenue laws of the United States as

⁶ Holocaust Restitution Tax Fairness Act (Pub. L. No. 107-358, 116 Stat. 3015 (2002); See also Joint Comm. On Tax’n, 107th Cong., Description of H.R. 4823 (Comm. Print 2002))

⁷ Jeremy Bearer-Friend, *Should the IRS Know Your Race? The Challenge of Colorblind Tax Data*, 73 Tax L.Rev. 1, 10 (2019)

damages for human suffering....”⁸ That meant, the payments would be treated the way Revenue Ruling 56-518 provided and be received tax-free.

Assuming reparations payments were tax-free at the federal level, for states with income tax systems that follow the federal tax treatment, that would mean those payments would be tax-free at the federal and state levels. For states that do not automatically follow federal income tax treatment, the authorizing legislation for reparations should include a provision making the receipt tax-free for state income tax purposes. But following a belts and suspenders approach, I would recommend that the State authorizing legislation make clear that any such reparations payments would be received tax-free under the state income tax system and to the extent you could get a similar provision to the Holocaust and Japanese American reparations included in federal legislation, that would be the most risk averse way to proceed.

Is there a different analysis if the reparations are non-monetary? What if reparations in the form of property are given? To the extent that it was a return of property, the Revenue Ruling provides us with one potential analysis. But there is an alternative legal analysis that could also lead to tax-free treatment. Let’s consider Bruce’s Beach.

When the family received the land, did they have gross income for federal tax purposes? State legislation made it clear that it would not be taxable for state income tax purposes. But what about federal income tax treatment?

For Bruce's Beach, there are equitable doctrines that either the IRS or a court could apply to ensure the receipt would be excluded from gross income. The doctrine of rescission is one possibility. Essentially the IRS would not recognize the transfer because the initial taking by the state was invalid. The IRS would look at the totality of the transaction and say considering all the

⁸ Civil Liberties Act of 1988, Pub. L. No. 100-383, § 105(0)(1), 102 Stat. 903, 908

facts and circumstances, they determine that nothing actually happened. The property was taken, but given back and we will just treat this like the initial improper taking was rescinded. Of course this relies upon the IRS, or last option, the court system to “do the right thing.” The better approach in my opinion is to get a legislative solution that would make it clear the payments were not taxable either at the federal or state level.

Who Pays?

Finally, I want to reiterate, that when you think through how to finance any such reparations payments, you need to carefully consider who pays. Having African Americans pay any part of their reparations would be entirely inconsistent with the intent and spirit of the Task Force’s goals. Recent survey data from the Pew Research Center⁹ showed that among all US adults who believe that descendants of people enslaved in the US should be paid reparations, 65 percent think that businesses and banks that profited from slavery should have all or most of the responsibility for repayment, compared with 53 percent who think that should be colleges/universities, compared with 44 percent who think descendants of families who engaged in the slave trade should have all or most of the responsibility for repayment. (By the way 75 percent think the federal government should have all or most of the responsibility for repayment.)

Thank-you for allowing me to testify today.

⁹ Carrie Blazina and Kiana Cox, Black and White Americans are far apart in their views of reparations for slavery, Pew Research Center, November 28, 2022. <https://www.pewresearch.org/fact-tank/2022/11/28/black-and-white-americans-are-far-apart-in-their-views-of-reparations-for-slavery/>