



Statement before the House Committee on Ways and Means  
Subcommittee on Select Revenue Measures  
On Tax Relief to Support Workers and Families during the COVID-19 Recession

# **Tax Policy and the Federal Response to COVID-19**

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Chairman Thompson, Ranking Member Smith, and members of the committee, thank you for the opportunity to speak to you today about tax policy in the federal government's response to the COVID-19 pandemic. My name is Kyle Pomerleau, and I am a resident fellow at the American Enterprise Institute. My research focuses on federal tax policy.

In my testimony, I will provide an overview of the major ways the federal response has used tax policy to provide economic relief to individuals and businesses. In addition, I will make four main points.

1. Although there is room for improvement, the tax provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act provided timely economic relief to individuals and businesses.
2. The economy appears to be recovering but is still not in great shape, and businesses and individuals may require additional economic relief. Any additional assistance through the tax code should be well targeted and temporary.
3. Lawmakers should avoid arbitrary denials of appropriate tax relief.
4. Although the federal government's fiscal imbalance must be addressed, lawmakers should avoid raising taxes while the economy is still weak.

## Background

To slow the rapid spread of COVID-19, states and localities issued lockdown and shelter-in-place orders, and individuals began to practice social distancing. The goal of the public health response was to "flatten the curve" and reduce the number of active COVID-19 cases at any given time, thereby reducing the strain on the US health care system and limiting the number of fatalities during the pandemic.

Although these mitigation measures were necessary to fight COVID-19, they resulted in a massive decline in economic activity. In March, real consumer spending declined by 6.7 percent and fell an additional 13.2 percent in April.<sup>1</sup> The unemployment rate jumped from 4.4 percent in March to 14.7 percent in April.

In response to the economic slowdown, Congress has passed five pieces of legislation, providing a total of \$3.6 trillion in economic relief. Support came in the form of additional health care spending, loans, and tax relief and deferrals for individuals and businesses. The Federal Reserve authorized up to \$6 trillion in asset purchases and emergency lending programs. The administration has enacted policies that will provide another \$380 billion in relief, mostly by delaying the tax filing deadline. The total federal response thus far could be as large as \$10 trillion, depending on Federal Reserve action, and, after accounting for repayments and deferred payments, may ultimately increase federal debt by at least \$4 trillion by the end of the decade.<sup>2</sup>

The federal response to the pandemic, so far, is better described as economic *relief* rather than economic *stimulus*.<sup>3</sup> Economic stimulus consists of increases in government spending or tax reductions to increase aggregate demand and boost economic output. The federal response, in contrast, has focused more on providing economic assistance to businesses and individuals so they can pay their bills and make payroll while the economy was locked down to fight the virus.

This distinction is important. Providing rebate checks to individuals may have had a limited impact on the economy because lockdowns and social distancing meant people did not have the opportunity to spend the cash. However, the policy may have been successful in providing economic relief by helping

households pay bills and avoid hardship during the lockdown. It also made it easier for households to comply with public health advice.<sup>4</sup>

### **Many of the Tax Measures Provided Timely Economic Relief to Both Individuals and Businesses.**

Lawmakers provided a significant portion of economic relief for individuals and businesses through tax provisions. The majority of the tax provisions were enacted as part of the third COVID-19 relief package, the CARES Act. The CARES Act included rebates for individuals, tax relief for businesses, and employer-side payroll tax relief. According to the Joint Committee on Taxation, the tax revenue provisions in the CARES Act will cost the federal government \$556.6 billion over the next decade (Table 1).

**Table 1. Major Revenue Provisions in the CARES Act**

	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2020–30</b>
<i>Economic Relief Rebates</i>	-\$268.9	-\$23.4	\$0.0	-\$292.3
<i>Business and Corporate Tax Provisions, Total</i>	-\$164.6	-\$74.4	\$4.3	-\$173.9
<i>Expand Net Operating Loss Limitation from 80 Percent to 100 Percent of Taxable Income</i>	-\$80.0	-\$8.7	\$3.1	-\$25.5
<i>Elimination of Excess Loss Limitation for Pass-Through Businesses</i>	-\$74.3	-\$64.0	\$1.7	-\$135.0
<i>Increase Income Limitation for Net Interest Deduction from 30 Percent to 50 Percent</i>	-\$7.1	-\$4.9	-\$0.5	-\$13.4
<i>Modification of Corporate Alternative Minimum Tax Credit</i>	-\$3.2	\$3.2	\$0.0	\$0.0
<i>Deferral of Employer OASDI and SECA Tax</i>	-\$211.1	-\$140.7	\$171.0	-\$12.3
<i>Employee Retention Credit</i>	-\$49.1	-\$5.5	\$0.0	-\$54.6
<i>Retirement Provisions</i>	-\$10.5	-\$3.2	\$0.6	-\$7.1
<i>Charitable Contribution Provisions</i>	-\$1.4	-\$5.0	\$2.4	-\$2.6
<i>All Other Provisions</i>	-\$0.7	\$0.2	-\$1.0	-\$13.7
<i>Total</i>	-\$706.2	-\$251.9	\$177.3	-\$556.5

*Source: Joint Committee on Taxation*

In general, the tax provisions in the CARES Act aimed to provide economic assistance to individuals and liquidity for businesses during the economic downturn. I will now discuss three major tax provisions of the CARES Act.

#### **Economic Relief Payments for Households**

The largest single revenue provision in the CARES Act is the economic relief rebates for households. The rebate for a tax filer is equal to \$1,200 (\$2,400 for married couples filing jointly). The rebate is increased by \$500 per child, and there is no cap to the number of children that qualify. The entire rebate amount phases out by five cents for each dollar of adjusted gross income above \$75,000 (\$150,000 for married

couples filing jointly and \$112,500 for heads of household). The rebates are estimated to cost \$292 billion.

Although there are reasonable ways lawmakers could improve the rebates, lawmakers provided economic relief to the vast majority of households. I estimated that 84.4 percent of all filers (150 million taxpayers) would receive the full benefit, and 7 percent (12.2 million taxpayers) would receive a partial rebate, with a \$1,729 average rebate for each eligible household.<sup>5</sup>

The IRS has done a good job of getting these rebates out quickly. According to the Committee for a Responsible Federal Budget, \$267 billion in rebate payments have gone to Americans, which is over 91 percent of the total amount estimated by the Joint Committee on Taxation and about 100 percent of what the committee said would go out this year.<sup>6</sup>

### **Net Operating Loss Deductions**

The CARES Act also provided tax relief for businesses. Most of the relief is through an expansion of net operating loss (NOL) deductions. The CARES Act liberalized the tax treatment of business losses in three ways. First, when businesses “carry forward” losses to offset profits in subsequent years, the act temporarily allows the losses to offset 100 percent of the profits in each future year, an increase from the 80 percent limitation established under the Tax Cuts and Jobs Act (TCJA).<sup>7</sup> Second, the CARES Act temporarily allows firms to carry back losses to up to five years, offsetting profits in those prior years and allowing an immediate refund of taxes paid on those past profits. Before the TCJA, firms could carry back losses up to two years and, under the TCJA, they could not carry back losses at all. Third, the CARES Act suspended a TCJA provision that limited the amount of losses that owners of pass-through businesses could use to offset other income to \$250,000 (\$500,000 for married couples).

The expansion of NOL deductions would reduce revenue by about \$155 billion over the next decade. The temporary expansion of loss deductions was a logical way to provide liquidity to firms. Firms that face losses can quickly offset previous years’ taxable income and get a refund, thereby increasing cash flow and helping businesses continue to pay bills during the downturn.

Congress also expanded loss deductions during the 2008 financial crisis. In fact, the TCJA’s loss limitations that were temporarily suspended under the CARES Act were criticized before the pandemic as potentially exacerbating future recessions by reducing firm cash flow when they need it most.<sup>8</sup>

### **Net Interest Deductions**

The CARES Act also temporarily increased the amount of net interest expense (interest expense in excess of interest income) a business could deduct against its taxable income, from 30 percent of adjusted taxable income to 50 percent. According to the Joint Committee on Taxation, this would reduce revenue by \$13.4 billion over the next decade.

Temporarily lifting the limitations on net interest deductions was also a reasonable way to provide relief to firms during a downturn. Increasing the deductibility of interest reduces the after-tax cost of borrowing, making emergency borrowing to increase cash flow easier.

### **Any Additional Assistance Through the Tax Code Should Be Well Targeted and Temporary**

In May, the US economy saw a surge in the number of individuals employed and a decline in the unemployment rate, with 2.5 million jobs added according to the Bureau of Labor Statistics. If the virus subsides, we may continue to see large increases in employment and economic growth. However, due to a sharp drop in employment and economic activity in March and April, the economy will remain well below its potential for at least several years.<sup>9</sup> Even with the 2.5 million new jobs, 19.6 million fewer workers have a job today than they did in February. The May unemployment rate was 13.3 percent, higher than at any point during the Great Recession.

Given the present state of the economy, businesses and individuals will likely need additional support. If lawmakers continue to use the tax code to provide additional assistance, they should ensure that tax relief is temporary and well targeted to individuals and businesses affected by the pandemic. Lawmakers should avoid using the pandemic to pass tax policies unrelated to the current pandemic and recessions.

Some recent proposals have failed to be temporary, well targeted, and geared toward addressing the current economic situation. For example, the White House recently suggested a capital gains tax cut or holiday for the next relief package. There are benefits to addressing the taxation of capital gains. However, it is unlikely to provide much assistance to households and businesses in need. It would make more sense to liberalize the treatment of capital losses during a recession, as many taxpayers are realizing losses, not gains.<sup>10</sup>

The White House has also suggested enacting a number of narrowly targeted tax deductions for certain industries, such as allowing business meals to be fully deductible. This would be poor tax policy because it could allow business owners to disguise their personal consumption as a business expense. A deduction like this may encourage some to dine out more, but it will have a limited effect on the industry. People will remain uncomfortable with dining out until they feel safe.

House Democrats have suggested lifting the limit on the state and local tax deduction. As with a capital gains tax cut, the majority of the benefit of this provision would go to high-income households—households in least need of economic assistance. According to the Tax Policy Center, 56.5 percent of the benefit would go to households in the top 1 percent.<sup>11</sup> The state and local tax deduction, over time, may provide states more flexibility in raising revenue, but this is unlikely to occur during the current downturn. If lawmakers want to provide assistance to states, they should do so directly.

### **Lawmakers Should Avoid Arbitrarily Limiting Tax Provisions**

Over the past month, various media outlets, analysts, and lawmakers have criticized the net operating loss provisions passed as part of the CARES Act. Some have characterized these provisions as a “stealth bailout” for the oil and natural gas industry<sup>12</sup> or as a boon to rich real estate investors.<sup>13</sup>

As a result, House Democrats introduced provisions that would pare back the loss provisions in the CARES Act. The Heroes Act would reinstate the pass-through loss limitation and make it permanent. In addition, it would disallow the use of carrybacks for corporations with “excessive” executive compensation, dividends, and stock buybacks, and it would not allow losses to be carried back in years before 2017.

There is little justification for these arbitrary limits. The correct treatment of losses for any business should not depend on the business’ executive compensation or dividend or share buyback policies. Limiting loss provisions could harm the cash flow of firms that need it and unnecessarily penalize risky

business investment. If lawmakers are concerned about executive pay, payouts to shareholders, or how much millionaires pay in tax, they should raise income taxes directly on these groups.

### **In General, Lawmakers Should Avoid Raising Taxes While the Economy Is Still Weak.**

Before the pandemic, the federal government had a significant fiscal imbalance. According to the Congressional Budget Office's (CBO) March 2020 baseline, federal debt held by the public as percentage of gross domestic product (GDP) will increase from about 80 percent of GDP in 2020 to 97 percent of GDP in 2030. The recession caused by the pandemic and the federal response will add more to the debt as tax revenues fall and spending increases. Lawmakers may have an interest in addressing the imbalance with tax increases and spending cuts.

However, the cost of borrowing today is low. The yield on the 10-year Treasury rate has been below 1 percent since early April. Even before the pandemic, borrowing costs for the federal government were relatively low. According to Federal Reserve data, federal interest outlays have remained below 1.5 percent of GDP for most of the past decade. It rose slightly to 1.75 percent of GDP in 2018 and 2019, when the 10-year Treasury rate was 3 percent and taxes were cut.<sup>14</sup>

Raising taxes now would impede economic relief and recovery. Higher taxes on businesses would reduce their cash flow and make it more difficult for them to maintain payroll, hire, and invest. Likewise, higher taxes on individuals would have a short-term negative impact on household budgets.

The federal government does face a long-term fiscal imbalance and will eventually need to cut spending and raise additional tax revenue. Lawmakers should focus on efficient sources of revenue that would have a limited impact on the economy, such as a value-added tax, a carbon tax, and base broadening by eliminating inefficient tax expenditures. Additional revenue could be used to simultaneously reform the tax code and reduce the budget deficit.

### **Conclusion**

Tax policy has been an important component of the federal government's response to the pandemic-induced economic slowdown. While there is room for improvement, many provisions provided needed relief for businesses and individuals. It is likely the economy will need additional relief. If lawmakers decide to provide more tax relief, it should be well targeted.

Meanwhile, lawmakers should avoid arbitrarily limiting tax provisions and raising taxes, especially while the economy is still weak. Lawmakers should also consider that, although tax policy can provide temporary relief, there is a limit to its effectiveness in the current situation. Ultimately, the most effective way to get the economy back to normal is to get the virus under control.

## Notes

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<sup>1</sup> US Bureau of Economic Analysis, "Personal Income and Outlays: April 20," May 29, 2020, <https://www.bea.gov/news/2020/personal-income-and-outlays-april-2020>.

<sup>2</sup> US Committee for Responsible Federal Budget, "COVID Money Tracker: Policies Enacted to Date," April 20, 2020, <http://www.crfb.org/blogs/covid-money-tracker-policies-enacted-to-date>.

<sup>3</sup> Grace Enda, William Gale, and Claire Haldeman, "Careful or Careless? Perspectives on the CARES Act," Brookings Institution, March 27 2020, <https://www.brookings.edu/blog/up-front/2020/03/27/careful-or-careless-perspectives-on-the-cares-act/>.

<sup>4</sup> Enda, Gale, and Haldeman, "Careful or Careless?"

<sup>5</sup> Kyle Pomerleau and Burke O'Brien, "The CARES Act: Who Will Get a Rebate and How Much?," American Enterprise Institute, March 30, 2020, <https://www.aei.org/economics/the-care-act-who-will-get-a-rebate-and-how-much/>.

<sup>6</sup> US Committee on Responsible Federal Budget, "Over Half the COVID Fiscal Support Is Now Out the Door," June 11, 2020, <http://www.crfb.org/blogs/over-half-covid-fiscal-support-now-out-door>.

<sup>7</sup> Kyle Pomerleau, "Loss Deductions Are Not a Bailout," American Enterprise Institute, May 21, 2020, <https://www.aei.org/economics/loss-deductions-are-not-a-bailout/>.

<sup>8</sup> Bill Gale and Yair Listokin, "The Tax Cuts Will Make Fighting Future Recessions Complicated," *Hill*, February 23, 2019, <https://thehill.com/opinion/finance/431284-the-tax-cuts-will-make-fighting-future-recessions-complicated>.

<sup>9</sup> Phillip L. Swagel, letter to Charles E. Schumer, "Comparison of CBO's May 2020 Interim Projections of Gross Domestic Product and Its January 2020 Baseline Projections," Congressional Budget Office, June 1, 2020, <https://www.cbo.gov/system/files/2020-06/56376-GDP.pdf>.

<sup>10</sup> Alan Viard, "Capital Losses, Not Capital Gains, Need Urgent Tax Relief," American Enterprise Institute, May 7, 2020, <https://www.aei.org/economics/capital-losses-not-capital-gains-need-urgent-tax-relief/>.

<sup>11</sup> Tax Policy Center, "T18-0140—Repeal \$10,000 Limit on Deductible State and Local Taxes; Baseline: Current Law; Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2018," September 24, 2018, <https://www.taxpolicycenter.org/model-estimates/repeal-10000-state-and-local-tax-salt-deduction-limitation-sep-2018/t18-0140-repeal>.

<sup>12</sup> Jennifer A Dlouhy, "'Stealth Bailout' Shovels Millions of Dollars to Oil Companies," *Bloomberg*, May 15, 2020, <https://www.bloomberg.com/news/articles/2020-05-15/-stealth-bailout-shovels-millions-of-dollars-to-oil-companies>.

<sup>13</sup> Jesse Drucker, "Bonanza for Rich Real Estate Investors, Tucked Into Stimulus Package," *New York Times*, March 26, 2020, <https://www.nytimes.com/2020/03/26/business/coronavirus-real-estate-investors-stimulus.html>.

<sup>14</sup> Federal Reserve Bank of St. Louis, "Federal Outlays: Interest as Percent of Gross Domestic Product," March 26, 2020, <https://fred.stlouisfed.org/series/FYOIGDA188S>.