Statement before the House Committee on Ways and Means
Subcommittee on Select Revenue Measures on
"Consequences of Inaction on COVID Tax Legislation"

Efficient and Targeted Tax Policy During the Coronavirus Pandemic

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September 11, 2020

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Dear Chairman Thompson and Ranking Member Smith,

Thank you for the opportunity to appear today before the Committee on Ways and Means Subcommittee on Select Revenue Measures. My name is Alex Brill, and I am a resident fellow at the American Enterprise Institute, a nonpartisan think tank in Washington, DC. I had the honor and pleasure of serving on the staff of this Committee earlier in my career, and I recognize the importance and impact of this Committee's jurisdiction on our national well-being, including assisting in the recovery from the current pandemic.

My testimony begins with an overview of the economic impact of the pandemic and our current economic situation. I then make five recommendations for tax policies that would help unemployed workers return to work and facilitate the continuity of health benefits for laid-off workers:

1) Expand the employee retention tax credit
2) Expand the child and dependent care tax credit
3) Offer premium assistance to cover the cost of COBRA
4) Enact the Safe and Healthy Workplace Tax Credit
5) Temporarily expand the Work Opportunity Tax Credit

I also address several provisions that should not be enacted – namely, a second round of economic rebate payments, elimination of the cap on state and local tax deductions, and an expanded child tax credit – and highlight budgetary concerns with costly and poorly targeted tax relief. Finally, I emphasize the urgency of legislative action.

Impact of Coronavirus Pandemic on the US Economy

The coronavirus pandemic has inflicted severe damage in a multitude of forms, including loss of life, loss of employment and income, and forgone education. More than 180,000 individuals in the United States have died from COVID-19, and more than 380,000 have been hospitalized. More than 55 million students in K–12 and their parents were directly affected by school closings last spring, and many – perhaps most – will continue to be affected by limitations on in-person learning this fall. More than 25 million college students (and their parents) have been similarly impacted. Businesses across the economy, but particularly in the hospitality industry, have been hard hit by shutdown orders and drops in demand.

The US economy has begun to recover from the brunt of the economic shock associated with the pandemic, but the recovery is challenging for many workers and segments of the economy. According to establishment survey data, US nonfarm employment initially fell by 22.2 million, from 152.5 million in February 2020 to 130.3 million in April. Since then, employment has recovered by almost half, to 140.9 million in August, a significant improvement in just four months. Nevertheless, the level of employment in the US last month remained low, similar to the level last seen in March 2015. Moreover, the rate at which private-sector employment is returning to pre-pandemic levels appears to have slowed. Much of the job loss has been concentrated in the hospitality and leisure sector, which initially lost 8.3 million jobs, approximately half of the sector's jobs. As of August, half of the lost jobs in this sector had returned, but total employment in the sector remains 4.1 million below its peak. Other job losses were dispersed broadly across multiple sectors.

Household survey data also confirm that the labor market is weak, but less weak than in April. The unemployment rate, which spiked by more than 11 percentage points, from 3.5 percent in February to 14.7 percent in April, was 8.4 percent in August.

The unemployment rate rose the most for those with the least education and remains most elevated for these workers. For workers with only a high school diploma, the unemployment rate in August was 9.8 percent, which is 6.2 percentage points higher than in February 2020. For workers with a bachelor's degree or higher, the August unemployment rate was 5.3 percent, 3.4 points higher than in February.

Although the economy is improving, millions of workers remain out of work. Approximately one-fourth of workers have a child under the age of 13, and many of them confront challenges as many schools remain partially or fully physically closed. Many businesses are struggling, as they face continued decreased demand for their products and services.

Real GDP contracted 1.3 percent (a 5 percent annual rate of decline) in the first quarter of 2020 and another 9.1 percent (a whopping 31.7 percent annual rate of decline) in the second quarter. Real GDP was 10.3 percent lower in the second quarter of 2020 than in the fourth quarter of 2019. The second-quarter GDP was similar to the 2014 level.

Recent monthly economic indicators reveal that the economy has improved from its low in April. The Industrial Production Index, which initially fell from 109 to 91, had recovered to 100 by July. The Census Bureau's Advanced Retail and Food Service Sales data for June shows a full recovery to pre-pandemic levels. Nevertheless, the consensus among private forecasters and the Congressional Budget Office (CBO) is that the overall US economy will not return to pre-pandemic levels until 2022.

Policymakers should be relieved by the degree to which our economy has rebounded since April but should also be concerned about the large gap remaining in our labor market and business output.

CARES Act Provided Large-Scale and Timely Economic Relief to Workers and Businesses

Enacted on March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was the largest single economic relief package in American history. The CARES Act included the Paycheck Protection Program (PPP), enhanced unemployment insurance payments, direct recovery payments to households, and a multitude of other relief and emergency funding programs and tax provisions.

As a result of the CARES Act and other coronavirus-related measures, the federal deficit is projected to increase by $2.3 trillion in fiscal year 2020, to $3.3 trillion. Specifically, CBO estimates that the CARES Act and other measures will increase outlays by $1.8 trillion in fiscal year 2020 and decrease revenues by $538 billion.

The CARES Act, with broad bipartisan support, provided strong support to the US economy and US workers. The single largest tax provision – recovery rebates of $1,200 (individual), $2,400 (married filing jointly), and $500 per qualified child – totaled $293 billion. Expanded unemployment benefits were estimated to total $268 billion.

Other tax provisions, including more generous treatment of net operating losses and the employee retention tax credit, reduced taxes by more than $300 billion in fiscal years 2020 and 2021 (excluding provisions that only shift the timing of tax payments).

The PPP program has provided 5.2 million loans totaling $525 billion. The program stopped issuing new loans on August 8, 2020, with $134 billion of remaining funds. The average PPP loan was $101,000, but two-thirds of all PPP loans were less than $50,000. Nearly two-thirds of the loans (by dollar amount) went to six industries: healthcare and social assistance; professional, scientific, and technical services; construction; manufacturing; accommodations and food services; and retail trade.

Next Steps for Tax Policy and Pandemic Recovery

Since enactment of the CARES Act, Congress has considered additional policy measures, including additional tax relief to mitigate the consequences of the pandemic and assist in promoting economic recovery. In May 2020, the House passed the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, which contains over $900 billion in net tax relief in fiscal years 2020 and 2021. Overall, the bill contains dozens of distinct tax provisions.

Given the magnitude of fiscal relief already provided, the preliminary improvements in the economy, and the appropriate role of other policy measures in addressing the consequences of the pandemic, a tax package that is smaller and more targeted than what is proposed in the HEROES Act is more appropriate.

Lawmakers should recognize that there is an urgency in the timing of additional legislative action, and I encourage Congress to act swiftly – but to enact only those provisions for which there is consensus and sound rationale.

Specifically, three provisions in the HEROES Act would be most effective in helping unemployed workers return to work and facilitating the continuity of health benefits for laid-off workers: 1) expansion of the employee retention tax credit, 2) expansion of the child and dependent care tax credit, and 3) premium assistance to cover the cost of COBRA for workers who have been laid off and who elect to continue their insurance coverage. These policies, with the modifications outlined below, should be high priorities for Congress. In addition, two other tax relief provisions would be appropriate: the Healthy Workplace Tax Credit and a temporary expansion of the Work Opportunity Tax Credit.

1. ***Employee Retention Tax Credit***

The Employee Retention Tax Credit (ERTC) was established in the CARES Act to encourage businesses to retain workers through the pandemic. The current ERTC, which is available for the remainder of 2020, is a refundable tax credit that is worth up to $5,000 per worker for eligible firms. Businesses are eligible if they are shut down by government order or have a 50 percent decline in quarterly revenue from a year ago. Qualifying firms with fewer than 100 workers can claim the credit for all workers, while larger firms can claim the credit only for employees still on payroll who are not working because of the pandemic. The credit is relatively modest, and firms that take PPP loans are ineligible. There have been multiple legislative proposals to expand the ERTC, including a provision in the HEROES Act and a provision in the Senate Health, Economic Assistance, Liability Protection and Schools (HEALS) Act.

There are meaningful differences between the House-passed and Senate Republican proposal, but the intent of both proposals is the same: to expand the ERTC to improve its usefulness and effectiveness at encouraging firms to rehire or retain their workforce. In an article last month, I compared the current ERTC, the House-passed expansion, and the Senate Republican proposal and outlined recommendations for a cost-effective compromise.

I suggested that lawmakers adopt the following five parameters for an expanded ERTC.

1. Eligible firms should be those that have been shut down by a government order or have experienced a decline in revenues of 20 percent.
2. The wage credit rate should be 80 percent but without the phase-in included in the HEROES Act.
3. The wage cap should be raised to $12,500 per quarter.
4. The definition of qualified wages should remain as defined in the CARES Act and not expanded, which means the credit is available for all workers at firms with less than 100 employees and affected workers at larger firms.
5. The retroactivity of the credit should be minimized. The House-passed expansion of the ERTC provided firms a windfall benefit by making changes effective March 12, 2020. The Senate's effective date of July 1 is more appropriate. However, given the passage of time, the effective date could now be set to September 1, further reducing the fiscal impact of this policy. The savings accrued from this change could be used to raise the wage cap further or to extend the policy to March 31, 2021.

These five parameters would preserve most of the critical incentives of the provision while reducing the overall cost and increasing the policy's efficiency.

A well-functioning ERTC has the potential to significantly aid the labor market. In fact, many other developed countries have adopted policies similar to a robust ERTC. By subsidizing the cost of keeping workers on payroll during the pandemic, the policies have helped to keep a lid on rising unemployment in those countries. As the Organisation for Economic Co-operation and Development (OECD) wrote recently:

> About 60 million workers across the OECD have been included in company claims for job retention schemes, such as the German Kurzarbeit or the French Activité partielle. Such schemes allow preserving jobs at firms experiencing a temporary drop in business activity, while providing income support to workers whose hours are reduced due to a shortened workweek or temporary layoffs. The use of these instruments plays a major role in explaining why most other OECD countries did not experience the massive surges in open unemployment that were registered in Canada and the United States.

2. Child and Dependent Care Tax Credit

The child and dependent care tax credit encourages work by offsetting the childcare costs associated with earning wages. As my AEI colleague Alan Viard has noted, the child and dependent care tax credit "plays an important role in encouraging work by providing tax relief for expenses that are closely linked to work. An improved and expanded credit can help offset the work disincentives of the income tax and boost economic growth." The current credit, which is as high as 35 percent for taxpayers with adjusted gross income (AGI) up to $15,000, phases down to 20 percent for those with AGI greater than $43,000. The credit is limited to the first $3,000 of childcare costs for the first child and a total of $6,000 for workers with two or more children. The credit is nonrefundable.

The HEROES Act significantly expands the child and dependent care tax credit in four ways. First, it doubles the amount of eligible expenses to $6,000 (one child) and $12,000 (two or more). Second, instead of reducing the credit amount for taxpayers with AGI greater than $15,000, the HEROES Act would begin to phase down the credit at AGI of $120,000. Third, the credit would become fully refundable. And finally, the maximum credit amount is increased from 35 percent to 50 percent. In the HEROES Act, this provision is proposed only for 2020, but the House also recently passed H.R. 7327, the Child Care for Economic Recovery Act, which includes permanent versions of the same changes.

While many of the reforms of this provision are sensible and will facilitate parents remaining or reentering the workforce, the 50 percent credit rate is too high, and the structured phasedown of the credit creates needless complexity and raises the effective marginal tax rate on income. A more sensible approach to reforming and expanding this provision would be to keep the maximum credit rate at 35 percent, eliminate the phasedown entirely, and limit the refundability of the credit to 15 percent (the payroll tax rate). Such changes would reduce the cost of this provision significantly while still preserving its intent and more closely aligning the credit rate to taxpayers' marginal tax rate on wage income. Given the impact of the pandemic on in-person education at public schools, this credit will likely prove particularly important in the near term.

3. COBRA Premium Support

Workers who have lost their job have the option of continuing their employer-provided health insurance at their own cost for a limited period of time. This policy, known as COBRA, allows for continuity of insurance coverage and can be especially valuable at a time like the present, when the US is facing a pandemic. This coverage is often very costly. The HEROES Act proposes to fully finance the cost of COBRA premiums between March 1, 2020, and January 31, 2021, by providing employers a tax credit against their payroll taxes.

There is significant value in preventing interruptions in insurance coverage generally, and all the more so during a pandemic. However, this policy, costing nearly $100 billion for less than one year, is very expensive. A more reasonable approach would be to subsidize only a portion of the cost of COBRA premiums. The American Recovery and Reinvestment Act of 2009 provided a similar temporary provision and subsidized 65 percent of premium costs. A subsidy rate higher than 65 percent would encourage additional utilization of the credit and fewer interruptions to insurance coverage. Lawmakers should consider a credit rate of 80–90 percent of COBRA premium costs.

4. Healthy Workplace Tax Credit

The Healthy Workplace Tax Credit, introduced by Congressman Tom Rice (R-SC) and included in the Senate Republicans' proposed HEALS Act, is intended to encourage businesses to provide testing, reconfigure workspaces, acquire personal protective equipment, and take other safety measures to reduce the risk of COVID-19. The credit is a 50 percent refundable credit against payroll taxes subject to a per-employee cap of $1,000 for the first 500 employees, $750 for the next 500 employees, and $500 for each employee thereafter.

To encourage wide adoption of public health and safety measures and reduce the risk of transmission of the coronavirus, Congress should enact this proposal. To simplify the credit and reduce its revenue loss, Congress should consider setting a $500 per-employee cap for all businesses.

5. Temporary Work Opportunity Tax Credit Expansion

The proposed HEALS Act also includes a temporary expansion of the Work Opportunity Tax Credit to include qualified unemployment insurance recipients. Hiring these workers would entitle employers to a

50 percent tax credit against the first $10,000 in first-year wages. The credit would be available from the date of enactment through January 1, 2021. Congress should consider extending the eligibility window to a later date in 2021.

Provisions That Should Not Be Enacted

Three large tax provisions – a second round of economic rebate payments, elimination of the cap on state and local tax deductions, and an expanded child tax credit – are included in the HEROES Act but should not be included in a final tax package. Numerous other provisions, not discussed here in detail, are also extraneous, not well targeted, overly costly, or otherwise inappropriate tax policy.

1. Economic Rebate Payments

Another round of economic recovery payments is not necessary given that such relief is not well targeted toward households directly impacted by the pandemic. At a cost of more than $435 billion, this is the most costly tax provision in the HEROES Act. Recognizing that this policy has both bipartisan and bicameral support and that it may be unrealistic to expect that it be dropped entirely, I encourage lawmakers to minimize the size and scope of the payments if unable to avoid this policy entirely.

2. State and Local Tax Deductions

One of the least effective provisions in the HEROES Act is the temporary repeal of the $10,000 cap on state and local tax deductions. As Brookings Institution researchers Richard Reeves and Christopher Pulliam noted earlier this week in the *New York Times*, "This is not a tax cut for those hit hardest by the virus. Families in the middle 60 percent of the income distribution nationally would see, on average, a minuscule reduction in their tax bill, around $25." In fact, given the large increase in the standard deduction established in the Tax Cuts and Jobs Act (TCJA) of 2017, permitting full deductibility of state and local taxes would be far more regressive in 2020 than it was in 2017.

As CBO has noted:

> An argument in favor of capping the deduction is that the Federal Government should not provide a tax deduction that subsidizes the spending of State and local governments because revenues from State and local taxes are largely paid in return for services provided to the public. When used to pay for public services, such taxes are analogous to spending on other types of consumption that are nondeductible. . . . Additionally, the unlimited deductibility of taxes could deter States and localities from financing some services with nondeductible fees, which could be more efficient.

This policy is not targeted toward taxpayers directly affected by the pandemic and the recession, and, at a cost of $136 billion, it is one of the costliest tax provisions in the HEROES Act.

3. Child Tax Credit

The child tax credit was doubled from $1,000 to $2,000 as part of the TCJA, and the HEROES Act proposes significant expansions for 2020 by making the credit fully refundable and raising the maximum credit to $3,000 for children aged 6–17 and to $3,600 for children under 6. This would cost more than $100 billion for one year, and lawmakers would undoubtedly attempt to make this policy a permanent fixture in the tax code, costing more than $1 trillion over the decade. The policy does nothing to encourage economic growth. It is also not well targeted at providing relief, as eligibility is not related to current hardship.

Conclusion

Given the severity of the economic contraction in the spring of 2020, lawmakers acted appropriately to swiftly enact large-scale fiscal relief. As lockdowns have subsided and more businesses are operating, the economy has improved. Nevertheless, economic weakness persists. As a result of policy actions and the weaker economy, the fiscal 2020 federal deficit is projected to swell to 16 percent of GDP, the largest deficit since 1945. In the coming years, the federal debt is projected to reach its highest level as a share of GDP every recorded. While large but temporary federal deficits can be appropriate in times of crisis, sustained large deficits pose significant risks for the US economy.

Enactment of the full HEROES Act, as passed by the House of Representatives, would add significantly to the budget deficit, with many of the costs attributable to misdirected and unnecessary provisions. Targeted and efficient tax relief is sensible and appropriate as are well designed spending measures. Given the longstanding fiscal imbalance in the United States, Congress can simply not afford to pursue such indiscriminate tax policy.

Thank you for the opportunity to appear before the Committee.