COVID-19: HOW THE TAX CODE CAN HELP THE ECONOMY RECOVER

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The coronavirus has taken over Washington, D.C., if not through infection, then through a focus on policy prescriptions to help the nation economically recover from the impacts. Volatility in the stock market, disruptions in normal business operations, and changes in everyday life as we know it have triggered serious discussions in the Trump administration and on Capitol Hill about a tax stimulus package to counteract the negative effects of the coronavirus on the U.S. economy. Discussions are very much in flux, changing hour to hour, and many policy options are under consideration. While some think this response may be an overreaction, the greater the dips in the stock market and the more tangible any negative effects on jobs and the economy, the more likely we are to see action on some sort of tax stimulus package in the near future.

The good news is that this scenario presents significant opportunities for stakeholders to help shape the contours of such a package, whether it involves legislation or executive action. This could include policies both directly and perhaps less directly related to the impact of the coronavirus. Viable tax titles are few and far between these days, so if measures can be characterized in any way as stimulative, they stand a chance of being included. Our lawyers and professionals have been involved in the development of these types of tax packages for decades, and are well positioned to advise clients on the forthcoming proposals and their potential impacts

PRIOR TAX STIMULUS AS A MODEL

Legislation enacted in the wake of the 2008 economic crisis and a series of disaster relief bills may be models for a coronavirus response. However, because the circumstances leading to the current situation differ from those in 2008 or a sudden catastrophe caused by a tornado, flood, or hurricane, specific policy responses are likely to differ as well. For example, the immediate cause of the current upset is primarily traced to the coronavirus, suggesting that the economy will turn around once the virus is under control — a finite and predictable outcome. In 2008 and the following years, the economic downturn was predicated on systemic issues that had been building over time — so more systemic changes that would take a longer period of time to effectuate were viewed as necessary. Unlike a catastrophe, buildings and infrastructure remain intact, so remedies may focus more on the impact on the workforce and business interruption.

Relief discussions are a moving target. Administration officials and Senate Finance Committee Chairman Chuck Grassley have suggested they are interested in relief focused on particular industries, such as airlines and hospitality, or specific economic sectors, such as small business, rather than a wholesale relief effort. President Trump also said the administration is considering a number of proposals that were used following the 2008 downturn, including a payroll tax cut, payroll relief for hourly workers, making it easier for small businesses to obtain loans, and focusing on relief for small businesses. Most, but not all, of these measures would implicate the tax code.

In contrast, House Democrats are focusing initially on non-tax relief. Their "Families First Coronavirus Relief Act" focuses on paid emergency sick leave, expansion of unemployment insurance, food assistance for kids and seniors, free testing, protections for frontline workers, and increased Medicaid funding to states. Senate Democrats have floated a relief plan that combines many of the House's non-tax policies with assistance for businesses. However, since the entire economy appears destined to be affected, a broader approach, whether through one bill or multiple legislative proposals, including both tax and non-tax policies, is likely to gain more acceptance as time goes by.

Similar to the 2009 American Reinvestment and Recovery Act, an infrastructure package has also been floated as a way to provide economic stimulus and create jobs for individuals who become unemployed as a result of the disruptions created by the coronavirus. Certain components of an infrastructure plan could involve the tax code, including business credits, tax-exempt bonds, depreciation incentives, and other measures.

STIMULUS V. 2020

The following are some suggestions for tax-related actions that the administration and Congress could take at this time to help stem the current downslide, mitigate the ill effects to companies and individuals affected, and reinstate economic stability and growth. This list is not all-inclusive, but it demonstrates the broad scope of possible tax actions that the administration and Congress could take to shepherd the country through this volatile period. Note that other policies being considered may not run through the tax code, but revenue measures to pay for them would, if it is determined that any of the cost must be offset rather than characterized as emergency spending.

In most cases, these proposals would require legislative changes rather than administration action. Note that these ideas are in no particular order, priority, or likelihood of adoption.

PRINCIPLES

- **Provide relief for individuals negatively affected.** These effects could include lost wages from layoffs, being ill, being quarantined, or having to stay home with children whose schools are closed. Additional costs could arise from testing, securing medical supplies and services, clinic and hospital visits, day care costs for children whose schools are closed, or increased transportation costs if not using public transit.

- **Provide relief for employers who are incurring additional costs or losses.** For example, losses could arise from interruption in the supply chain or lack of demand for products and services as customers stop traveling or going to public places. Additional costs could result from increased sanitation efforts, equipping employees with laptops to be able to work at home, and lost productivity due to employees working at home.

- **Expedited action to calm the markets, boost the economy, and reassure individuals as quickly as practicable.** Using policies that have been used or vetted previously will contribute to expedited action. This includes protocols at the Internal Revenue Service to administer them promptly.

- **Focused assistance for particular industries.** Identify particular industry sectors most at risk and provide targeted relief, as appropriate. The nature of the assistance would depend on the particular needs of the industry. This approach may encounter resistance among members of Congress who might perceive the help as inconsistent and unfair, creating winners and losers depending on the taxpayer, particularly if their constituents are not among those receiving the benefits.

- **Retroactive changes.** Revisions to the tax code could be made retroactively, providing immediate cash flow as taxpayers file their 2019 tax returns or perhaps use carrybacks to prior years.

PROPOSALS

- **Payroll tax cut.** This has been used before as a stimulus. Depending on how it is structured, a payroll tax cut can reduce employers' payroll costs and/or put more money in workers' pockets. One criticism is that the difference in pay is de minimis and people do not really notice it (or appreciate it, politically). If someone is laid off, they are not receiving a paycheck, so a cut in payroll taxes has no effect on cash flow. Since the 2008 economic crisis, the gig economy has grown substantially; if a person is paying self-employment taxes (via the Self-Employment Contributions Act rather than the Federal Insurance Contributions Act), a payroll tax cut will not have immediate effect unless it is made refundable. A payroll tax cut also puts strain on the Social Security trust fund since fewer taxes are being paid into the fund, yet benefits for workers do not decrease.

- **Tax rate cuts.** This could be on the employer side or the individual side. These could be temporary or permanent. Because they would reduce the amount of tax withheld or estimated taxes paid, they would have a similar effect as a payroll tax cut in the near-term.

- **Sending a check to individuals.** This is another mechanism used in prior stimulus efforts. Putting cash in peoples' pockets that can be spent and multiplied throughout the economy is considered by some to be one of the most effective ways to boost the economy. While the concept sounds simple, actually figuring out to whom and where the checks should be sent is a complex task potentially involving several federal agencies.

- **Delaying payment of estimated taxes or filing tax returns.** The tax code already includes provisions to allow delay of payment of taxes, e.g., in case of disaster. This does not reduce the taxes owed but delays the due date of the taxes, hopefully until after cash flow has been restored. Alternatively, it keeps those dollars in circulation in the economy. These delays could be without interest or penalty charges.

- **A moratorium on forgiveness of indebtedness income.** If an individual defaults on a loan and the loan is written off, the forgiven debt generally is taxable. If default occurred as a result of a coronavirus-related layoff, the tax could be forgiven.

- **Delaying, repealing, extending, or making permanent certain provisions that were used as pay-fors in the 2017 Tax Cuts and Jobs Act tax form legislation ("TCJA").**
  - This could include repeal or delay of the increased limitations on interest expense deductibility and stretching out deductions for research and development or advertising expenses.
  - A common stimulus tool, bonus depreciation, was increased to 100 percent in the TCJA, so it is not available for an immediate stimulus effect. However, the 100 percent bonus is slated to begin phasing out in 2023, so it could be extended or made permanent to give businesses confidence to plan and place orders for capital expenditures in years 2023 and later. Making the 100 percent bonus

permanent reportedly is on President Trump's list for Tax Reform 2.0, expected to be released this summer. An unresolved technical correction to the TCJA that would allow qualified improvement property to qualify for the 100 percent bonus depreciation could be addressed as part of this effort.

    - The 199A pass-through deduction is slated to expire in 2025. Extending it or making it permanent could provide additional long-term stability to pass-through businesses, many of them small businesses. Making the deduction permanent is also reportedly on the president's wish list for Tax Reform 2.0.
    - Lifting the $10,000 deduction limitation on state and local taxes could provide quick cash flow through increased tax refunds if made retroactive to 2019.
    - Restoration of net operating loss carrybacks could provide prompt cash flow to businesses with net operating losses using expedited claim procedures.

- **Expanding/making refundable family tax credits.** These could include the child tax credit and the earned income tax credit. This has been a priority of Democrats when negotiating with Republicans on fixes and technical corrections to the TCJA.
- **Monetizing unused business tax credits.** Allowing a business with unused credits to monetize or receive those tax credits currently (perhaps at a reduced percentage) rather than having to carry them over would provide cash flow for operations, wages, and capital expenditures.
- **Allowing refundable credits in lieu of bonus depreciation.** Companies with losses who cannot use all of their depreciation deductions would benefit from monetizing those losses through tax credits.
- **Reimbursements for costs incurred for employees to work at home.** The cost of laptops, faster internet, office equipment, software, computer security, and other needs associated with telework could be offset with credits, rebates, or deductions for individuals who otherwise would not itemize because of the larger standard deduction enacted in the TCJA.
- **Incentives to relocate business operations to the United States from other jurisdictions.** These could include tax credits or enhanced deductions. Such incentives could address concerns about supply chains and accomplish a goal of the administration and many in Congress to bring jobs and businesses back to the United States.
- **Enhanced charitable deductions.** Allowing 2020 donations toward coronavirus causes to be deducted on 2019 tax returns, or allowing a charitable deduction for taxpayers who take the standard deduction, could encourage giving to food pantries, shelters, and other organizations assisting victims.

INFRASTRUCTURE

The 2009 American Reinvestment and Recovery Act included stimulus provisions to build roads, bridges, and other infrastructure, and this could be an option to counteract the negative effects of the coronavirus. The administration, House, and Senate all have indicated their desire for an infrastructure bill, but the discussions have been at an impasse over politics, policy, and pay-fors. The coronavirus could create an amenable environment for an infrastructure bill that Republicans and Democrats could get behind. An infrastructure stimulus could include something for businesses and something for individuals, meaning something for Republicans and something for Democrats alike. Each party could get something they want, be able to live with something the other party wants, and perhaps not have to worry about paying for the package if it is deemed to be emergency spending. To this point, Senate Appropriations Chairman Richard Shelby has acknowledged that an infrastructure bill could help protect the U.S. economy from the coronavirus. He noted that offsets still need to be identified, but the need for pay-fors could attenuate commensurately with the extent of damage to the economy and jobs from the virus. Many issues can be characterized as having a nexus to infrastructure with a little creative thinking.

OTHER ISSUES

If a coronavirus stimulus bill evolves into a must-do package, the administration and Congress may use the opportunity to try to tack on additional items that do not fit neatly into the stimulus category but that have been stalled for various reasons. This could include TCJA technical corrections, such as the qualified improvement property retail glitch, other TCJA legislative tweaks, certain temporary tax provisions, and other items. In many cases, a colorable argument could be made that these measures would be favorable to economic growth, making them germane to the underlying bill.

INTERNATIONAL IMPACT

Just as the coronavirus knows no borders, it also has the potential to impact international tax policy.

OECD/EU digital tax initiatives. The Organization for Economic Co-operation and Development ("OECD") is in the midst of a global effort to revamp international tax policy so it reflects the modern economy, including the taxation of digital services and online sales of products and services outside the home jurisdiction. This is a race against time, since the European Union ("EU") and member states of the EU are lying in wait with their own versions of a digital tax that have been criticized as targeting U.S. companies. The administration and Congress are unified in their opposition to a regime that unfairly targets U.S. businesses. Negative effects on the U.S. economy from the coronavirus are likely to strengthen their resolve that any efforts to tax the digital economy should not disproportionately impact U.S. multinationals. This could further jeopardize the chances of success at the OECD level and increase the odds that a series of unilateral digital taxes will be imposed instead.

Stimulus actions around the world. The United States is not alone in considering tax policies to counteract the negative economic effects of the coronavirus. A number of countries around the world also are using their tax codes to take on the coronavirus, including the following.

- China is delaying a tax deadline, and it has provided small and medium-sized businesses with tax and fee incentives.
- France will reduce direct taxes on businesses on a case-by-case basis.
- Italy plans to introduce tax cuts and credits, and it has suspended tax payments for a period of time.
- Germany has announced a plan to provide liquidity for businesses and to increase annual federal investments.
- Hong Kong proposed one-time waivers of personal and corporate income taxes.
- New Zealand is considering unspecified tax relief for small businesses.

CONCLUSION

While the eventual path of the coronavirus remains unclear, it seems likely that the administration and Congress will turn to the tax code to mitigate any damage and help restore the U.S. economy. This creates an opportunity for businesses and individuals to provide input into the process to help shape policies that will contribute to a full recovery. Please contact the author or any member of the K&L Gates public policy practice if you have questions, concerns, or suggestions about a tax stimulus package.

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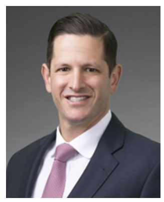

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