Insight

The Good, the Bad, and the Ugly: Tax Policy in the HEROES Act

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Executive Summary

- The Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act contains a reported $3 trillion in new federal fiscal obligations – including substantial tax changes.
- The Act contains 54 separate tax provisions, including several new or expanded transfer payments, expanded hiring incentives, and retirement policies.
- The Act contains worthwhile improvements to Coronavirus Aid, Relief, and Economic Security (CARES) Act policies that should be considered by Congress but is also bloated with inappropriate or misguided tax policies.

Introduction

Congress has passed three major pieces of legislation (plus one substantial supplement) in response to the COVID-19 pandemic, including the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the largest single fiscal intervention in U.S. history. As policymakers grapple with the persistent risk of infection and a prolonged recession, additional fiscal assistance is likely. Democrats in the House of Representatives released the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, which contains 19 separate Titles and reportedly on the order of $3 trillion in new spending and fiscal aid.

The Act has been described as a partisan exercise without any hope of passage in the Senate or support from the White House. It is tempting to dismiss the Act in its entirety as a partisan, election-year wish list, which it substantially is. To the extent that Congress will need to provide additional support to the struggling economy, however, it is worthwhile to identify those elements of the HEROES Act that go beyond mere progressive box-checking and make good-faith policy improvements. It is also important to identify particularly egregious tax policies in HEROES that should be left on the House floor.

The Good

Congress enacted the CARES Act after about one week of debate and stood-up a new policy regime of the same fiscal magnitude as the entire FY2000 federal government. The practical reality of that effort is that CARES Act policies need refinement, replenishment, and other changes to address the scope and scale of the COVID-19 pandemic. This real-time reform should be an ongoing executive and congressional function to address programmatic deficiencies in practice.

Assistance to Individuals

As an initial proposition, the effort in HEROES to make concrete legislative changes to CARES is to be applauded. The Internal Revenue Service and the Treasury are to be commended for administrative actions to improve access to CARES Act Economic Impact Payments, but some challenges for specific taxpayers have arisen that will require statutory clarification. The HEROES Act contains six separate changes to the existing Economic Impact Payment (EIP) regime, three of which are largely designed to preclude payments from being subject to garnishment or reduction due to past-due child support obligations or otherwise diverted. These instances are likely rare as a share of overall payments, and while many of these cases are likely not sympathy-inducing, the EIP program was designed to provide moderate-to-lower income Americans with emergency household liquidity. If that is the goal, the clarifications in HEROES are a coherent response to implementation challenges in delivering those payments as broadly as was intended.

HEROES also contains six provisions in Subtitle F that provide increased flexibility for employee benefits. The provisions allow workers to carry over balances in certain use-it-or lose-it accounts, including flexible spending accounts, and provide additional access and extended grace periods for the reimbursement of eligible expenses. These are commonsense solutions that should be included in the next legislative response to COVID-19.

Assistance for Businesses

Subtitle D of the of the revenue division of the HEROES Act contains four provisions that clarify or otherwise refine the tax treatment of the Paycheck Protection Program (PPP). Specifically, HEROES would allow recipients of PPP loan forgiveness to defer payroll tax payments; such recipients were denied that benefit under CARES. The Act would exclude from taxation the forgiveness of Small Business Administration (SBA) loans, emergency Economic Injury Disaster Loan (EIDL) grants, and other payments. Additionally, the Act would clarify that expenses paid with PPP loans and other similar credit programs (e.g. SBA, EIDL, etc.) are deductible; this clarification is consistent with the views of the Chairman and Ranking Member of the Senate Finance Committee and the Ranking Member of the House Ways and Means Committee.

The Bad

While the HEROES Act contains some worthwhile tax policy changes, they comprise a relative minority of the provisions. Instead, HEROES is loaded with 54 discrete tax proposals that run the gamut from another round of substantially expanded EIP disbursements to small new tax deductions. The COVID-19 pandemic should not be an excuse for enacting unrelated policies or showering favored constituencies in new tax benefits. Enshrining favored policy under the guise of a temporary COVID-19 response should be rebuked.

The most conspicuous example of this are subtitles C, D, and E of HEROES, which contain 10 provisions that variously expand the Earned Income Tax Credit, the Child Tax Credit, and the child and dependent care tax credit. Expansions of these policies have been progressive priorities well prior to the COVID-19 pandemic. Indeed the Ways and Means Committee passed essentially these provisions last summer. While couched as temporary, one can easily envision these becoming a new annual "tax extender," and essentially becoming a permanent fixture of the tax code – and with a cost upwards of $1 trillion over 10 years.

The Ugly

While there are tax policies in HEROES that should become law when Congress next debates COVID-19 relief, and tax policies that may be worth debating on their merits outside of pandemic-relate legislation, one tax policy in HEROES is so laughably egregious, it's ugly: "Sec. 20161. Elimination for 2020 and 2021 of limitation on deduction of state and local taxes."

The Tax Cuts and Jobs Act imposed a $10,000 limitation on state and local tax deductions, more commonly referred to as the SALT cap. The cap was imposed to broaden the tax base – raising revenue all else equal. As the Joint Committee on Taxation has found, this policy change in HEROES would be costly and poorly targeted, costing on the order of $100 billion per year with the benefits accruing overwhelmingly to high-income taxpayers. Indeed, the average household making over $1 million per year would receive over $100,000 in additional tax benefits. This tax change is uniquely unsuited to any pandemic-related legislation and has exactly no chance of becoming law in this Congress.

Conclusion

The Senate largely crafted the CARES Act, prompting Speaker Pelosi to release a wish-list of pent-up progressive policy proposals and name it the HEROES Act. It is not the first time COVID-19 has been invoked to rationalize bad policy, and it will not be the last. The HEROES Act is indeed redolent with longstanding progressive policies that will not become law; perhaps the crassest is a $100,000 tax cut for metropolitan high-earners. The HEROES Act, however, is the statement of policy priorities by Democrats in the House of Representatives and can’t be ignored. There is good reason to find the good-faith policy changes in HEROES that might contribute to a constructive debate. Turns out there are a few.