Federal stimulus favors wealthy investors and major companies

BY ROBERT POZEN, OPINION CONTRIBUTOR — 05/13/20 04:00 PM EDT
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Tucked into the 880 pages of the Cares Act are two complex provisions suspending restrictions on the tax deductions of business losses. These provisions allow wealthy investors and large corporations to reap billions of dollars in tax benefits from business losses that are incurred not only due to the coronavirus, but also in years before the pandemic.

A new Senate bill introduced by Sheldon Whitehouse, which matches a House bill, must be passed promptly by Congress. The legislation would allow these tax benefits only for business losses incurred this year. It also would limit the availability of these tax benefits to smaller companies and deny benefits to the individuals who earn the highest incomes.

These Cares Act suspended critical restrictions in the Tax Cuts and Jobs Act, which sharply lowered the top income tax rate for corporations and the owners of most partnerships. Congress adopted two restrictions on tax deductions for net business losses to make up some of the resulting revenue losses. These have been suspended by the Cares Act.

The first restriction stopped wealthy individuals who own pass through businesses, such as partnerships, from deducting excess net business losses to reduce their other income, including their investment income. The Tax Cuts and Jobs Act considers net business losses to be excess if they exceed $250,000 per individual or $500,000 per couple annually, and any excess losses can be carried forward to future years.

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Suppose a married real estate developer had $10 million in net business losses and $10 million in capital gains from her stock investing last year. Under the first restriction, she would have to pay taxes on $9.5 million of capital gains, which cannot be reduced by real estate losses.

In the Cares Act, Congress suspended this first restriction for 2018, 2019 and 2020. Therefore, in our example, the real estate developer would not pay any taxes on her $10 million in capital gains, which would be offset by her real estate losses last year. The recent Senate bill would reinstate this first restriction with its limits to deduct excess business losses.
The suspension of the first restriction by the Cares Act provision may now reduce tax revenues by $135 billion over the next decade, as estimated by the Joint Committee on Taxation. It further estimated that for 2020 alone, more than 80 percent of $85 billion in tax benefits will go to over 40,000 taxpayers with $1 million or more in income. These millionaires are mainly wealthy investors in hedge funds and real estate professionals, according to Steven Rosenthal, a senior fellow with the Tax Policy Center.

The second restriction prevented corporations from using net business losses in one year to collect tax refunds from prior years when they had net income. Before the tax cuts, federal code let corporations carry back all losses two years and forward 20 years. But Congress changed this with the tax cuts to allow corporations to only carry forward their net business losses to offset future income and therefore lower future taxes.

Suppose a technology company had $500 million in net business losses in 2018, after several years of generating profits. Before the tax cuts, the company could use this $500 million in losses to offset prior profits and obtain tax refunds for those years. After the tax cuts, the company could only use this $500 million loss to offset profits in future years.

In the Cares Act, Congress suspended this second restriction by letting corporations offset income from five prior years for all net losses in 2018, 2019 and 2020, generating refunds for the taxes paid in these prior years. Therefore, in our example, the technology company could right away use its $500 million in losses in 2018 to obtain refunds for the taxes it paid in 2017 and earlier. Although this suspension appears sensible for business losses incurred this year because of the coronavirus, this rationale does not justify special treatment for losses incurred in 2018 or 2019.

The suspension of the second restriction is expected to save corporations $25 billion over the next decade, according to research conducted by the Joint Committee on Taxation. Those corporations that will benefit include many publicly traded companies capable of raising capital themselves. To better target federal government support, the Senate bill would apply this provision of the Cares Act only to companies earning annual revenues of $15 million or less and only for their losses incurred this year.

The Cares Act was supposed to send cash quickly to those suffering from the economic fallout of the pandemic. However, by suspending these two restrictions under the Tax Cuts and Jobs Act, Congress has bestowed tax windfalls on wealthy investors and large corporations. Congress needs to therefore reinstate these critical restrictions and channel the incremental revenues to more deserving Americans during this downturn.

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