SB 137: Supporting the CARES Act disconnect

Testimony for Senate Finance and Revenue Committee – Bennett Minton – 2.3.2021

Madam Chair and members of the Committee on Finance and Revenue:

Tax Fairness Oregon is a network of volunteers who advocate for a rational and equitable tax code. We strongly support the -1 amendment to SB 137.

We became alarmed about these CARES Act provisions in the spring, when their harm to the General Fund and their distributional effects came into focus. First, a coalition of members of Congress alerted their colleagues about the provisions tucked into the law. The Joint Committee on Taxation produced a distributional analysis of the business loss limitation provision: 82% will go to individuals reporting 2020 income greater than $1 million; those 43,000 taxpayers will receive an average benefit of $1.6 million. The total federal expenditure, JCT estimated, is $138 billion.

As you know, LRO has reduced its estimate of the revenue cost of these three provisions since May, thanks to Oregon's sunnier revenue outlook. But our concerns remain: The provisions represent a misguided allocation of limited resources created in Washington, not Salem.

I spent three decades in D.C. as a reporter and policy analyst, mostly in tax, and many hours in the Senate Finance Committee, where committee leaders struck many deals, including this one. The business-lobby witnesses in today's hearing contended that the CARES Act was bipartisan, based on the final vote. But as you know, legislation is a product of compromise. Ranking Democrat Wyden's priority was increasing unemployment benefits. Because Congress can print money, Wyden did not ultimately object to these three provisions, each of which was enacted in 2017 to limit big tax cuts on businesses. My summary:

- For net operating losses, the 2017 law made two major changes. First, the carryback period was eliminated, and the carryforward was extended indefinitely. (That is, they went from 2/20 to Ø/∞.) As LRO has explained, CARES temporarily extended the carryback five years for 2018, 2019 and 2020, allowing taxpayers to uses NOLs from these years to offset taxable income as far back as 2013.

- The business loss limitation—the subject of the JCT distributional analysis—was a new limit on pass-through entities. Its purpose is to stop taxpayers from using business losses to offset amounts greater than a half-million dollars in non-business income and end up with no tax liability. For example, if in 2018 my spouse and I had non-business income of $2 million and our businesses in aggregate lost $2 million, we could use only $500,000 of the business loss to offset the non-business income. As a result, we would still pay tax on $1.5 million. The rest of the loss

would carry forward as an NOL. Under the CARES suspension, we can amend our return and get a refund. We're in a very exclusive club.

- Third is the interest expense limitation—a provision I lobbied against during the Obama administration. Section 163(j) is intended to prevent companies from using interest deductions to make money elsewhere, a practice known as "earnings stripping." Years ago, Congress addressed earnings stripping in part by disallowing certain corporate interest expenses that exceeded 50% of the corporation's "adjusted taxable income," a complicated formula. In 2017, Congress applied that limitation to all taxpayers—with exceptions—and lowered the limit to 30%. Interest expense not allowed as a deduction may be carried forward indefinitely.

  What are the exceptions? In the 2017 law, the expansion of 163(j) did not apply to businesses with gross receipts of less than $25 million. Nor did it apply to dealers of motor vehicles, boats or farm machinery. It also left out, at the taxpayer's election, two other sectors: real estate and farming. Why these exceptions? Congress was carving out industries for which leverage transactions are essential.

So why did Congress suspend these provisions? The official explanation was to enhance liquidity during a sharp contraction. This makes little sense, because tax benefits—especially these—have little or no immediate effect. A taxpayer who filed an amended return for 2018 or 2019 would wait weeks or months for refund. For 2020, the taxpayer may count on a tax reduction over the course of the year, assuming the taxpayer projected any liability. But for a business that's losing money in the COVID contraction and therefore owes no tax, NOLs are not "liquidity." A beneficiary of these provisions is not the kind characterized here as a "struggling business." Nor is a taxpayer with a "struggling business" one to which the half-million-dollar loss limitation applies.

My conventional explanation for these provisions is born of experience: The lobbyists who won massive business tax cuts in 2017 never went away; they remained at the doors of the Finance Committee, looking to be relieved of these limits. Like other members of Congress, Finance Committee leaders like giving away money, but their method is the abstract tax code (and not, say, PPP loans). Those who pay a lot of tax hire lobbyists (like I was) to hang around their doors.

About half of states with an income tax share Oregon's rolling conformity to the federal code. As Senator Wagner noted, of those with rolling conformity, five—New York, North Carolina, Georgia, Colorado and Illinois—have disconnected from CARES Act provisions. New York's disconnection from the code applies through 2021, to protect its tax base from similar moves. Like the PPP double-dip, which the committee may consider formally.

In sum, these provisions are useless for struggling businesses in Oregon. Since Congress acted last March, we have witnessed a recovery that has shifted income upwards but left millions of Americans, and many thousands of Oregonians, hanging by a thread. One out of seven of our fellow citizens is hungry right now. Remaining connected in the face of urgent needs strikes Tax Fairness Oregon as irresponsible.