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FACTS AT A GLANCE **May 19th, 2020**

The CARES Act: Costly Tax Cuts for High-Income Filers

By Kurt Wise

Snapshot of Findings

- The CARES Act delivers $160 billion in tax cuts to high-income business owners and to corporations
- This total is more than is provided for safety net programs, hospitals or state and local governments
- Some 43,000 filers with over $1 million in annual income will average $1.6 million each in tax cuts over the next two years from the CARES Act
- Many of the same filers already are receiving large annual tax cuts from the 2017 Tax Cuts and Jobs Act (TCJA)
- The TCJA will deliver $324 billion in tax cuts in 2020, with half going to the highest-income 5 percent of households
- In Massachusetts, the highest-income 1 percent will average $60,200 each in tax cuts from the TCJA

During the weeks following enactment of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, it has come to light that this law – intended to deliver emergency, COVID-related relief – includes large tax cuts for a small subset of high-income business owners and for C-corporations. The total amount provided to these already-fortunate few filers (in particular, to hedge fund investors and real estate developers) turns out to be much larger than amounts provided to recipients obviously in greater need, including struggling families, state and local governments, and hospitals. Moreover, this latest round of generous tax cuts for high-income households and businesses comes on top of the massive cuts provided to these groups in the 2017 Tax Cuts and Jobs Act (TCJA).

As the coronavirus has shuttered large swaths of the national economy and thrown tens of millions out of work, many small business owners are fighting to stay afloat and to keep their employees safe and financially solvent. Providing sustained relief to these businesses is an urgent national priority. Unfortunately, as currently written, the CARES Act instead pours tens of billions in unwarranted tax windfalls into the pockets of high-income business owners and corporations already well-positioned to manage the financial impacts of the COVID pandemic.

The U.S. House has included repeal of many of these business tax provisions in the new Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, the latest major federal bill aimed at providing additional COVID-related support. Alternatively, it is possible to amend these CARES Act provisions to focus their benefits more narrowly on less well-off business owners – ones more likely to need federal help if their businesses are to survive into the post-COVID era.

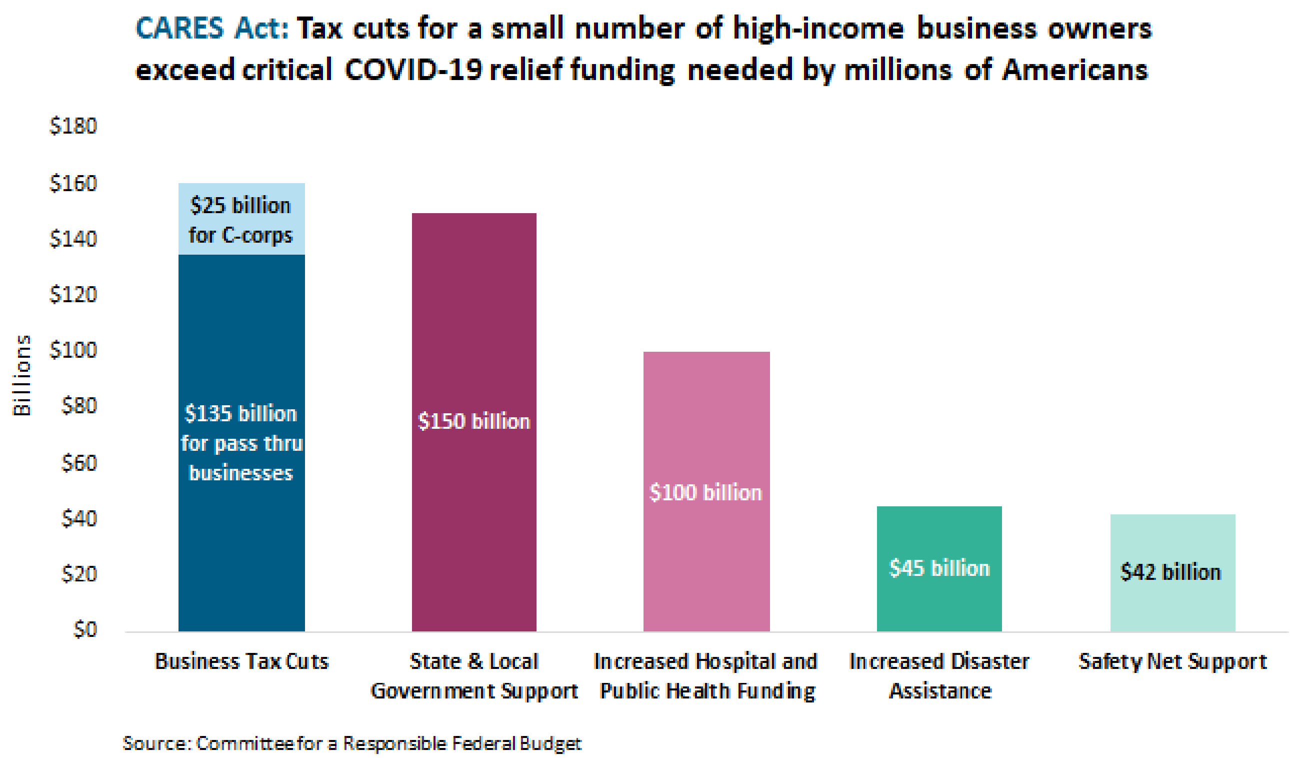
What is clear is that struggling families, communities, and the Commonwealth will need every dollar the federal government can deliver. Even with this help, however, an infusion of new state-level tax dollars also will be required. State-level efforts to raise new revenue must focus on those filers – both individual and corporate – that have profited handsomely from the tax cuts delivered through the CARES Act and the TCJA.

How big are the business tax cuts and who is getting them?

The Congressional Joint Committee on Taxation (JCT) estimates that the tax law changes included in the CARES Act will deliver $135 billion in tax cuts to high-income owners of pass-through businesses

(S-corporations, partnerships, LLCs, and sole proprietorships).[1] Over 80 percent of this windfall will go to some 43,000 households, each with over $1 million in annual income. On average, each of these high-income households will receive a tax cut of more than $1.6 million over the next two years. By contrast, the CARES Act provides a one-time tax rebate to most American households of just $1,200 for each adult filer and $500 for each child. The JCT further estimates that other changes included in the CARES Act will deliver another $25 billion in tax cuts to C-corporations (the designation chosen, for tax filing purposes, by many large, publicly-traded businesses).

As Americans for Tax Fairness has pointed out, this combined total – $160 billion – significantly exceeds amounts provided in the CARES Act for safety-net programs ($42 billion) like food stamps, for increased disaster assistance ($45 billion), for hospitals ($100 billion), or for state and local governments ($150 billion).



What are the CARES Act tax law changes that benefit businesses?

The CARES Act business tax changes fall into two basic categories: those that benefit only pass-through businesses and those that benefit both pass-throughs andC-corporations. In the first category, the Act removes the dollar caps on the amount of pass-through business losses that can be used in a single year to reduce a filer's taxable income from non-business sources (like salary income or income generated from the sale of stocks, bonds and other assets). Previously, no more than $250,000 of an individual's non-business income could be removed from her yearly taxable total (or $500,000 for married couples). The CARES Act removes these caps, a change that benefits only those pass-through owners with non-business income that exceeds the earlier caps.

The second category of changes includes permitting 100 percent of business losses to be deducted from taxable income. Previously, this deduction had been limited to 80 percent of taxable income. This change will allow businesses to book significant "excess losses" (losses that exceed a filer's taxable income), which can be used to reduce taxable income in other years. These rules apply not only to business losses incurred in 2020, but also to those incurred in 2019 and 2018, before the coronavirus pandemic ever hit. Further, business losses from 2018-2020 that are not used to offset taxable income in the year the actual loss occurred, may be carried backward for up to 5 years, offsetting taxable income in prior years. (Rules established in the 2017 Tax Cuts and Jobs Act (TCJA) allowed such losses only to be carried forward.) This will allow C-corporations and pass-through business owners to amend past year tax filings and thereby generate tax refunds, in some cases going back as far as 2013.

How does the 2017 Tax Cuts and Jobs Act (TCJA) fit into the picture?

The CARES Act tax changes benefiting high-income business owners and corporations add to the already huge cuts provided to these same groups in the 2017 Tax Cuts and Jobs Act (TCJA). Overall, the TCJA is expected to reduce federal tax collections by $1.6 trillion over the 2018-2027 time frame, with $750 billion of that total flowing to corporations. The Institute on Taxation and Economic Policy (ITEP) has estimated that U.S. businesses will see a cumulative tax cut approaching $140 billion for 2019 and over $115 billion in 2020. MassBudget estimates that Massachusetts businesses will claim about $4 billion of the 2019 total and a similar percentage of future year totals.

ITEP estimates that in 2020 alone, the TCJA will deliver total tax cuts of $324 billion (both individual and corporate tax cuts), over half of which ultimately will go to the nation's highest-income 5 percent of households. By contrast, the lowest-income 40 percent of households will receive only 5 percent of the total benefits. What do these numbers mean specifically for Massachusetts taxpayers? The top 1 percent of filers in the Commonwealth will see a federal tax cut from the TCJA averaging $60,200 in 2020, while those in the next highest 4 percent will see average cuts of $13,300. For the poorest 20 percent of households, the TCJA will deliver tax cuts averaging just $70.

What's the takeaway?

In addition to the grim and mounting death toll, the coronavirus crisis is doing still further damage to families across the Commonwealth by disrupting normal economic activity. Just as state and local governments are being called on to do so much more, tax collections are headed for a historic collapse. The 2017 TCJA and the 2020 CARES Act have showered large federal tax cuts on the nation's highest-income households, on owners of pass-through businesses, and on C-corporations. To avoid unnecessary and damaging state budget cuts, legislators should reform our state tax laws to collect a portion of this federal tax windfall. The big winners from the TCJA and CARES Act – and from the lopsided income gains of the last several decades – are well-positioned to contribute more at the state-level, while also successfully navigating the COVID recession.

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[1] Pass-through businesses are ones that have elected "to pass corporate income, losses, deductions and credits through to their shareholders for federal tax purposes." These businesses do not pay an entity-level corporate income tax. Instead, the owners pay tax on the business profits at the individual level, through the individual income tax. See Internal Revenue Service guide: https://www.irs.gov/businesses/small-businesses-self-employed/s-corporations

This is different from C-corporations, which pay tax at the entity level, before profits are distributed to shareholders. S-corporations typically have a relatively small number of shareholders (i.e., owners); they may have no more than 100 shareholders.