

The Senate's Coronavirus Bill: Bailouts, Missed Opportunities, and Positive Reforms

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KEY TAKEAWAYS

Congress's response to the economic consequences of the coronavirus should be targeted, temporary, and directed at public health efforts while limiting political abuse.

While the CARES Act includes positive reforms, providing \$200 billion in bailouts to select industries fails to meet these targeted and temporary objectives.

The Senate must significantly reform these special benefits to limit abuse, reduce the need for bailouts, and get aid directly to affected workers.

The pandemic associated with COVID-19 (or coronavirus) has significantly disrupted daily life all over the world and the United States. As the number of reported cases has increased, Congress has passed both an emergency appropriations bill and the Families First Coronavirus Response Act (FFCRA), which provides tax relief for paid leave as well as additional resources for social programs aimed at alleviating the spread of the disease and any economic consequences of the epidemic.¹ The Trump Administration has also taken a number of administrative steps aimed at improving the public health systems by reducing barriers for medical professionals to deliver a more appropriate level of care. Finally, the Federal Reserve has taken a number of actions to prevent the coronavirus epidemic from leading to a broader economic breakdown.

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Earlier this week, both Congress and the Administration launched discussions regarding a large fiscal stimulus package that is intended to prevent a recession. As we have specified in several papers over the past two weeks, any policy response by Congress to address the adverse economic consequences of the coronavirus epidemic should be targeted, temporary, and directed at aiding public health efforts.² At the same time, any fiscal response should not increase spending permanently.

Unfortunately, the Coronavirus Aid, Relief, and Economic Security (CARES) Act that was released on the afternoon of March 18 fails to meet many of these objectives. For instance, the bill provides over \$200 billion in special assistance to specific industries in a way that will likely encourage political abuse. That said, the CARES Act also provides a number of beneficial reforms with regard to labor, tax, health, and education policy. It also includes small-business loans that will function more like grants but are probably necessary if governments at all levels are encouraging businesses to stop operating for some period of time in order to slow the spread of the coronavirus epidemic.

However, the Senate should take great care to improve on the CARES Act by amending it based on the recommendations in this paper. These include expanding the paid leave credit included in FFCRA and creating a new program that allows the federal government to prepay anticipated future expenses of businesses directly affected by the coronavirus epidemic to help mitigate the fall in revenue that is associated with people having to change their behavior dramatically over a limited period of time.

Special Assistance to Specific Industries

Overnight, the bill would make the U.S. Treasury Department one of the largest investment banks in the country authorized to make loans to, guarantee loans to, and take equity positions in businesses of all types.

Section 3102 authorizes \$208 billion in loans and loan guarantees for three groups: \$50 billion is provided for passenger air carriers, \$8 billion for cargo air carriers, and \$150 billion for other businesses.

The loans and loan guarantees would be “in such form and on such terms and conditions and contain such covenants, representatives, warranties, and requirements (including requirements for audits) as the Secretary determines appropriate”³ and made at the discretion of the Secretary.⁴

The government is “authorized to enter into contracts under which the Federal Government, contingent on the financial success of the eligible business, would participate in the gains of the eligible business or its security

holders through the use of such instruments as warrants, stock options, common or preferred stock, or other appropriate equity instruments.”⁵ Thus, the government can be expected to take large equity positions in airlines and other businesses. Increases in compensation and bonuses for highly paid employees are limited until March 1, 2022, if a firm takes these loans.⁶

A bailout of this magnitude of large firms and with so few taxpayer protections is unwarranted. Furthermore, turning the Treasury Department into a large investment bank with almost unlimited discretion is a recipe for cronyism, favoritism, poor results, and taxpayer losses. At the very least, firms should be able to secure loans only in amounts that are demonstrated to be directly related to their crisis-related losses.

There are many ways that these provisions could be reformed to protect this program from abuse. For instance, the firms should be required to demonstrate that they cannot obtain credit from private sources on commercially reasonable terms, and the legislation should establish detailed criteria for what is deemed commercially reasonable. There should be collateralization requirements. The legislation should require that firm assets not otherwise previously encumbered should be pledged as collateral. The collateral should be of at least equal value to the loan or, if the collateral is insufficient, all of the firms’ unencumbered tangible and intangible assets. The legislation should require that the interest rates paid should be at least as high as those for low-rated corporate bonds.

Small Business Loans

The bill provides \$299.4 billion for small-business loans.⁷ In contrast, in fiscal year 2019, the Small Business Administration made \$23.2 billion of Section 7(a) loans.⁸ Small business is defined as “any business concern, private nonprofit organization, or public nonprofit organization which employs not more than 500 employees.”⁹

The loans would not to be underwritten based on creditworthiness. If the business existed on March 1, 2020, and had employees, it is eligible.¹⁰ Besides any stated business purpose, the loans may be used for payroll support, including paid sick, medical, or family leave, and costs related to the continuation of group health care benefits during those periods of leave, employee salaries, mortgage payments, rent, utilities, and any other debt obligations that were incurred before March 1, 2020.¹¹ Normal fees would be waived.¹² The maximum loan amount would be increased to \$10 million.¹³ The federal government will guarantee 100 percent of Section 7(a) loans

made by financial institutions.¹⁴ This is an increase from the typical guarantee percentages of 75 percent–85 percent currently.¹⁵

A very large proportion of these loans will be forgiven or, in other words, transformed into grants. Section 1105 provides that businesses taking these loans “shall be eligible for forgiveness of indebtedness on a covered 7(a) loan in an amount equal to the cost of maintaining payroll continuity” from March 1, 2020, to June 30, 2020.¹⁶ Payroll costs would exclude wages for any employee in excess of \$33,333 during the four-month period and qualified sick leave wages for which a credit is allowed under Section 7001 of the Families First Coronavirus Response Act.¹⁷

Some other limitations are imposed. The forgiven loans will not be treated as income for tax purposes.¹⁸

Ordinarily, a program anything like the program described above would constitute unwarranted government subsidy of business, harming the taxpayer and impeding the ordinary functioning of the market. However, in the current circumstances, local and state government orders have often made it unlawful for these businesses even to operate. Moreover, the federal government is instructing (although not ordering) the public not to patronize these businesses. The businesses must still pay their rent and mortgages and have millions of employees who rely on them for their livelihood.

If government continues to order them not to do business or severely restricts how they do business, most will be forced to lay off or furlough workers, and many of these businesses will fail. Because government orders driven by the desire to contain the coronavirus epidemic are the source of their financial distress, some level of government support is warranted. The magnitude of the support that is warranted is a function of how long government policies last, making it nearly impossible for these firms to do business, and the severity and duration of the epidemic. Ultimately, this is unknown at this point.

Labor

While the Families First Coronavirus Response Act and the CARES Act address paid sick and family leave provisions for independent workers and those who work for companies that employ fewer than 500 employees, it does nothing to protect workers of larger employers. Yet some of the industries that have been hardest-hit by the coronavirus include very large employers in areas of travel, tourism, and business services. By applying the same paid sick and family leave provisions to workers of

large employers—including quick access to refunds through employer credits—policymakers could reduce or eliminate the need for separate, selective bailouts to big business (also provided under this act and discussed above).

That said, the CARES Act also includes a number of positive reforms. The major provisions include the following:

Section 4606 allows for paid leave for rehired employees. The CARES Act allows employers to receive paid sick leave credits for employees who were recently fired (on March 1 or later) but for whom they rehire and provide sick leave payments. Extending the availability of this credit to recently fired but rehired employees could help restore workers to their previous positions when they might otherwise have been permanently separated from their employers and potentially unemployed for a significant amount of time.

Section 4603 adds authority to exempt small businesses from paid leave mandates. To help prevent small employers from going out of business or laying off workers, this provision provides added authority for the Secretary of Labor to use regulations to exempt some small businesses with fewer than 50 employees from being forced to provide paid leave. Hopefully, with the added immediate availability of paid leave credits, businesses will not need such exemptions.

Section 4607 provides for advance payments for paid leave credits included in FFCRA. The CARES Act allows employers and self-employed individuals to receive advance payments for their paid sick and family leave credits, effectively making such paid leave dollars available potentially within weeks instead of having to wait months or a year from now. This is very helpful, as many employers do not have the cash reserves to pay their employees for up to 60 days of sick and family leave, and without near-term access to the credits refunding their sick leave payments, they would either have to lay workers off or go out of business. This provision will hopefully reduce the need for heedless loans to small businesses (also made available under this act and discussed above), as effectively paying workers' wages is superior to providing taxpayer-financed loans and widespread loan forgiveness to companies.

Tax Policy

There are several provisions in the CARES Act that are problematic. Section 2101 provides “recovery checks” through advanced tax refunds of up to \$1,200 (single) or \$2,400 (married filing jointly) and an additional

\$500 per child. Based on 2018 tax returns, the rebate phases out starting at \$75,000 (single) and is reduced to zero at \$99,000. Taxpayers must have at least \$2,500 in qualifying income to qualify for a rebate.

Millions of Americans at this time are in need because of the widespread business closures. However, broad based relief is not a well-targeted prescription for this crisis. Despite major dislocations, most Americans do not need direct government aid. Government supports should be targeted toward keeping people employed and supporting those who do lose their jobs due to the coronavirus crisis. At the same time, sending checks to Americans (including those who have not lost their jobs) runs the risk of jeopardizing public health efforts if the intention is to encourage social distancing rather than going out into the economy to spend extra money.

However, a number of other of tax provisions are beneficial. For instance, the bill includes necessary tax relief for businesses and individuals by delaying tax filing deadlines, delaying estimated tax payments, expanding access to business net operating losses, and fixing long-postponed technical fixes to the 2017 Tax Cuts and Jobs Act.

Sections 2201 and 2202 would allow for the delay of estimated tax payments and payroll tax payments for business. Companies are able to delay the first two quarterly estimated tax payments of 2020 until October 15. The 6.2 percent employer payroll tax liability is delayed and required to be paid back over the following two years. These delays will provide needed temporary cash to businesses as they try to stay afloat.

Section 2101 would allow for the delay of filing deadlines for individuals. The typical April 15 tax filing deadline is postponed to July 15. This will allow the IRS and tax preparers to follow Centers for Disease Control and Prevention guidance for social distancing more easily and allow taxpayers to retain any money they would otherwise owe for an additional three months.

Sections 2203 and 2204 expand access to net operating losses. Specifically, these sections allow business tax losses from 2018, 2019, and 2020 to be credited against the last five years of taxes paid for an immediate refund and temporarily removes limitations on the ability to carry losses forward. Businesses would also be able to access larger interest deductions under Section 2206. These changes would allow struggling businesses to access tax benefits immediately that they would otherwise have to wait years to recoup.

Section 2103 provides for penalty-free retirement account withdrawals. This proposal would waive the 10 percent early withdrawal penalty for retirement account distributions of up to \$100,000 for coronavirus-related purposes. This allows Americans to access their own money in an emergency without facing additional penalties.

Sections 2104 and 2105 expand the charitable giving deduction. Individuals are permitted a \$300 “above the line” charitable deduction, which allows all taxpayers the ability to lower their taxable income by up to \$300 of their qualified donations. The normal charitable deduction is available only to those taxpayers who itemize their taxes. The limits for individuals and businesses on charitable giving deductions as a percent of income are temporarily lifted.

Section 2208 expands access to expensing for retail improvements. This allows businesses to fully expense qualified improvement property, fixing what is known as the “retail glitch.” This and two other technical corrections to the 2017 Tax Cuts and Jobs Act are included.

Health Policy

This proposal contains provisions that would provide needed flexibility to allow doctors and patients to respond to the pandemic more effectively. For example, the bill would build on recent Administration actions to remove barriers to the adoption of telehealth, which is the practice of letting patients consult with doctors via phone or video conferencing. Section 4404-5 makes it easier for Medicare recipients to access telehealth services; Section 4406 allows the Secretary of Health and Human Services to waive requirements for periodic face-to-face visits for certain Medicare patients; Section 4401 allows holders of Health Savings Accounts to spend money in these accounts on telehealth services. These are prudent steps to take, as telehealth offers obvious advantages—especially in a pandemic—that allow patients to get personal medical advice quickly without having to go to the doctor’s office first.

This proposal does, however, contain several proposals that go beyond the scope of this crisis. Section 4123, for example, provides grants to telehealth for the next five years, starting in the next fiscal year. Congress should instead focus its efforts on near-term relief that is directly tied to the current needs of the pandemic.

Education

This proposal would provide needed flexibility to public elementary and secondary schools across the country, along with higher education institutions and student borrowers.

Section 4511 of the bill includes a proposal that would grant the Secretary of Education the authority to grant emergency waivers from the

Elementary and Secondary Education Act (ESEA), currently known as the Every Student Succeeds Act, along with the Higher Education Act (HEA). The Secretary could waive both regulatory and statutory requirements levied on states by the federal government as they pertain to testing (and associated accountability measures) if a state submits a waiver request. If a state or school district believes the coronavirus is inhibiting its ability to comply with a particular component of the ESEA or the HEA, it could submit a request to the Department of Education seeking flexibility from that particular section of the law. If granted a waiver from the Department of Education, the waivers would be good for up to a year.

This addresses two major issues currently facing school districts: whether they must continue to administer federally mandated tests and whether they can provide online learning options without contravening requirements under the Individuals with Disabilities Education Act (IDEA).

With regard to federally mandated assessments, the Elementary and Secondary Education Act requires every state to administer reading, mathematics, and science assessments annually to all students in tested grades, the outcomes of which are used in state accountability plans. Although the U.S. Department of Education currently is providing targeted waivers to federal testing provisions under ESEA, this proposal could allow the department to provide a blanket waiver to all states, enabling them to postpone testing until this pandemic has subsided.

With regard to IDEA and students with special needs, in Washington State, for example, the Superintendent of Public Instruction “advised schools not to offer online classes unless they can ensure that lessons are provided on an equitable basis.”¹⁹ The Department of Education should further clarify a fact sheet it released in March 2020 telling districts to “ensure that students with disabilities have access to the school’s education program.” Although the fact sheet states that districts have flexibility in doing so, some districts and states are refusing to offer online learning options to any students out of concern that some students might not be able to access online content, particularly students with special needs. The Senate proposal instructs the Secretary to inform Congress as to whether or not waivers from IDEA’s regulations should be permitted. During this time of crisis, this would enable the Secretary to clarify that the agency will not punish schools for delivering instructional content online, even if it cannot ensure that every student will have access immediately.

Section 4513 of the bill would suspend student loan payments for three months, with secretarial discretion to extend the suspension for three additional months. There would be no accrual of interest during the

three-month period that students are not required to make payments. This is effectively enabling borrowers that are currently having trouble paying their students loans due to coronavirus-induced unemployment to qualify for interest-free forbearance. This is smart emergency policy that avoids blanket student loan forgiveness. Large-scale student loan forgiveness would be inappropriate and would place an additional burden on those who did not take out loans (which represents the vast majority of taxpayers).

A Better Option

A number of changes in the Senate’s CARES Act would improve the public health response while mitigating the economic effects directly associated with the coronavirus pandemic. We have discussed these policies in detail in other papers;²⁰ however, they are briefly outlined here:

Expand rapid and targeted paid sick and family leave assistance to employers with 500 and more workers. The FFCRA and the CARES Act address paid sick and family leave provisions for independent workers and those who work for companies that employ fewer than 500 employees. Both fail to protect workers of larger employers. Yet some of the industries that have been hardest-hit by the coronavirus response include very large employers in areas of travel, tourism, and business services. By applying the same paid sick and family leave provisions to workers of large employers—including quick access to refunds through employer credits—policymakers could reduce or eliminate the need for separate, selective bailouts to big business. The credit should also be expanded to all employees of businesses required to shut down or significantly slow down operations per government orders and recommendations for any period of time. It should also apply to businesses needing to reduce the number of employees who perform work or the hours of employees performing work.

Waive required minimum distribution rules. Americans ages 72 and older must take a “required minimum distribution” each year from their retirement account—a percentage—which increases with age. Given significant declines in the stock market in recent weeks, rules that require individuals to take large percentages out of their retirement accounts when they have suffered a significant loss can hurt retirees’ future finances. We should let them ride it out if they so choose. Middle-class savers who want to pass on their retirement benefits to their children would also benefit. Retirement accounts are one of the more common ways typical Americans receive an inheritance. When the government requires that these accounts be spent down, especially in market downturns, the rules actively destroy middle-class wealth.

Pre-purchase expected goods and services to supply businesses with liquidity, not bailouts. The federal government can inject billions of dollars into the economy at this critical time by pre-purchasing predictable goods and services from the private sector. Purchase agreements should target sectors such as travel and hospitality that are most harmed by the economic effects of the response to the epidemic. The government should make these purchases competitively, or based on a discount for single-sourcing, benefiting taxpayers with reduced future expenditures as well as participating businesses with immediate cash flow. A properly designed pre-purchase program would benefit everyone involved and support the economy at a critical time without being a bailout.

Conclusion

Congress has taken and can still take a number of steps to mitigate the economic effects associated with the coronavirus epidemic. We have outlined a number of those changes in previous papers. These include expanding the FFCRA tax credit to apply to businesses with more than 500 workers and to all persons who cannot reasonably telecommute in an epidemic area, as well as to employees of businesses required to shut down or significantly slow down operations per government orders and recommendations. It should also apply to businesses that need to reduce the number of employees who perform work or the hours of employees performing work. Furthermore, additional flexibility should be provided for states to receive federal assistance to respond directly to the public health challenges.

In addition to amending the provisions included in FFCRA, Congress could also create a program that allows the federal government to prepay anticipated future expenses for airlines, hotels, restaurants, and other businesses directly affected by the coronavirus epidemic to help mitigate the fall in revenue that is associated with people having to change their behavior dramatically over a limited period of time. Finally, there are several tax changes that Congress should enact that would help businesses by allowing income taxes to be smoothed over the business cycle while delaying payments.

However, the Senate's CARES Act misses this mark by including special benefits to specific industries that will total \$200 billion. These special benefits should either be replaced by policies that would help all companies or should be significantly reformed so as to limit abuse.

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Endnotes

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4. Section 3102(c)(1).
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6. Section 3103.
7. Section 1106.
8. Robert Jay Dilger, “Small Business Administration 7(a) Loan Guaranty Program,” Congressional Research Service *Report for Members and Committees of Congress*, updated October 15, 2019, <https://fas.org/sgp/crs/misc/R41146.pdf> (accessed March 20, 2020).
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10. Section 1102(d)(2)(B).
11. Section 1102(d)(1).
12. Section 1102(e).
13. Section 1102(c).
14. Section 1102(f)(1).
15. See Small Business Administration, “Types of 7(a) Loans,” <https://www.sba.gov/partners/lenders/7a-loan-program/types-7a-loans> (accessed March 20, 2020).
16. Section 1105(a)(2).
17. Section 1105(a)(4).
18. Section 1105(i). Normally a discharge of indebtedness would be income. See Internal Revenue Code, Section 108.
19. Robin Lake, “As Schools Shift to Virtual Learning, Educators Worry That Online Instruction Is Inequitable. But No Learning at All Is Worse,” *The74*, March 17, 2020, <https://www.the74million.org/article/lake-as-schools-shift-to-virtual-learning-educators-worry-that-online-instruction-is-inequitable-but-no-learning-at-all-is-worse/> (accessed March 20, 2020).
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