

TAX POLICY AFTER CORONAVIRUS: CLEARING A PATH TO ECONOMIC RECOVERY

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Key Findings:

- Short-term policies to “stimulate” economic growth after COVID-19 run the risk of producing short-term results and would likely prove insufficient and ineffective for sparking a long-term recovery.
- Lawmakers at all levels should focus on deliberate and comprehensive strategies to clear a path of the most economically harmful taxes that will prevent businesses and individuals from investing, creating jobs, and lifting the economy out of its slumber.

State Tax Policy Options

1. Modernize tax rules to be friendlier to the new trend toward remote and teleworking arrangements.
2. Modify nexus and enhance conformity to prevent needless double taxation impacting New Economy business models.
3. Stop states from taxing global corporate income.
4. Repeal burdensome taxes businesses must pay regardless of profitability.
5. Fix unemployment insurance (UI) systems to prevent tax hikes.
6. Broaden sales tax bases to generate needed revenue and avoid more harmful tax increases.

Federal Tax Policy Options

1. Prevent tax increases on capital investment and R&D by making full expensing permanent and extending it to factories and buildings.
2. Expand liquidity by allowing deductions to be “cashed out.”
3. Make the tax code more neutral and raise revenue by removing both the taxability and the deductibility of interest.
4. Prevent scheduled increases to the GILTI and BEAT rates, which would harm U.S. international competitiveness.
5. Repeal the tariff tax burden on American consumers and businesses.
6. Clear the tax path for entrepreneurs and gig workers in the New Economy by streamlining tax rules and creating safe harbors for platform companies.

Global Tax Policy Options

1. The Organisation for Economic Co-Operation and Development (OECD) should suspend its current work on reforming international tax rules—and the \$100 billion tax increase on digital companies—until the global economy returns to stable health.
2. The OECD should help countries reorder the mix of their taxes away from harmful corporate and individual taxes to less harmful consumption and property taxes.

Introduction

After expending considerable resources to keep their economies on life support during the COVID-19 crisis, governments at all levels are now looking at ways to relax the current restrictions and allow daily life to return to a new normal.

The typical response of lawmakers is to enact policies to “jump-start” or “stimulate” the economy with short-term measures such as subsidies, tax rebates, payroll tax holidays, and “shovel-ready” infrastructure projects. But history has shown that short-term policies lead to temporary results, if at all.

What economies from the state level to the global level need are not quick fixes but policies that are conducive to long-term economic recovery and growth. In most cases, this does not mean a new set of policies—it simply means that lawmakers need to clear a path of the tax obstacles standing in the way of businesses and individuals rebuilding their lives and the economy in the process.

Ideally, governments should work together to clear the path toward economic recovery because the poor choices made by one level of government can undermine the growth-enhancing policies of another level of government. What is needed, therefore, is a comprehensive approach to identifying the tax policies that are most harmful for long-term economic growth and getting each level of government to commit to removing or reforming those policies.

At the state level, this means that tax codes should be modernized to reflect a more interconnected economy. They should be revised to avoid penalizing investment, and to better correspond with ability to pay. And they should adhere to greater tax neutrality, letting the market—not policymakers’ goals or intuitions—guide economic decision-making.

At the federal level, this means improving certainty by making permanent the most pro-growth elements of the Tax Cuts and Jobs Act (TCJA) of 2017, especially the full expensing provisions. It also means repealing the TCJA’s business tax increases that are scheduled to trigger in just a few years. Lawmakers can also work within the tax code to improve liquidity by allowing businesses to “cash out” their deductions. Lastly, lawmakers must make the tax code friendlier to the “New Economy” entrepreneurs and gig workers. The future of the U.S. economy depends upon them.

At the international level, the Organisation for Economic Co-Operation and Development (OECD) should suspend its current work on reforming international tax rules—which could mean a \$100 billion tax increase on digital companies—until the global economy returns to stable health, say 2 percent annual growth. Moreover, the OECD should turn its attention to helping governments develop policies more conducive to long-term growth. In many cases, this will mean shifting their mix of taxes away from harmful taxes on business and individual income to less harmful taxes on consumption and immovable property.

In order to start this comprehensive thought process, Tax Foundation experts have identified an achievable menu of tax reforms at each level of decision-making that can clear the tax path to long-term economic recovery and growth.

Clearing the Tax Path for State Economic Recovery

When the immediate health crisis abates, states will be forced to grapple with depleted reserves and reduced revenues, while simultaneously seeking to adopt policies that will help enable—or at least not inhibit—an economic recovery. Revenue needs and a desire for enhanced competitiveness can be at tension with each other but need not be at odds. Whatever difficult decisions states make on taxes and revenues in the aftermath of the crisis, policymakers should at least regard it as an appropriate time to modernize state tax codes to make them more conducive—at any level of taxation—to economic growth and expansion.

State Reform #1: Modernize Tax Rules Impacting Multistate and Remote Workers

The nature of workplaces has changed. It is important not to overstate the magnitude of this transformation: most jobs still require on-site work. Still, adaptations designed to enable continued business operations amidst stay-at-home orders have likely accelerated a transition to more expansive telework policies, and tax regimes should evolve to reflect this new reality.

Our federal system grants each state substantial autonomy over its own taxes. This yields tax competition that often benefits taxpayers but can also lead to double taxation and substantial tax complexity for businesses and individuals with activity in multiple states. Working from another state for even a day—theoretically even responding to a work email while on vacation out of state—can be enough to trigger individual income tax withholding requirements in some states, and to expose an employer to business tax liability there. Greater employee mobility and expanded telework options, therefore, are expressly discouraged by tax codes through compliance costs and double taxation. Both federal and state reforms can lift these artificial constraints.

Workers should not incur tax filing or withholding obligations in a state for spending a *de minimis* amount of time there. In practice, states do not want the administrative obligations of processing no-liability returns, but many preserve the requirement nonetheless in hopes of being able to tax even a day of a well-compensated CEO's time. States should do away with this tedious and rarely enforced requirement, instead adopting a reasonable threshold of days in the state before such obligations exist. Alternatively, the federal government is empowered to create such standards, which have long been embodied in proposed "mobile workforce" legislation. A related federal initiative, often referred to as "telecommuter tax fairness," would eliminate the opportunity for double taxation that arises when the employer's state imposes income taxes on someone working, wholly or in part, from their home in another state.¹

1 Edward A. Zelinsky, "Combining the Mobile Workforce and the Telecommuter Tax Acts," Cardozo Legal Studies Research Paper, Aug. 19, 2012, <https://dx.doi.org/10.2139/ssrn.2129804>.

State Reform #2: Modify Nexus Standards and Enhance Tax Conformity

State tax codes have long lagged the interconnectedness of the modern economy, but especially as the very concept of a central workplace becomes more nebulous, the necessity of addressing issues of multistate taxation gain urgency. When businesses engage in economic activity in multiple states, it is necessary to determine which states have a right to tax them and how much of the business's net income those states can claim. Nexus is the determination of whether a business has sufficient presence in a state for that state to tax any of its activity; apportionment determines the division of that income to yield the appropriate share for a given state to tax. Without some standards for nexus and apportionment, there would be nothing to prevent states from taxing businesses that have no connection to that state, or from taxing the entirety of a business's income even though it is also taxed in other states on much or all of that income.²

Under federal law, nexus cannot attach to a corporation just because it solicits sales of tangible property in a state. There must be some further economic activity, like having property in the state or having employees work there. This requirement, codified by P.L. 86-272,³ was originally intended as a temporary measure until a permanent policy could be worked out; nearly 65 years into this "temporary" regime, it is in desperate need of an update to reflect a much more services-oriented economy, rather than only shielding businesses selling tangible goods.⁴ The federal Business Activity Tax Simplification Act (BATSA) legislation reflects one possible approach to modernizing this provision.

Although state tax codes vary from the federal Internal Revenue Code (IRC) in many important respects, nearly all use the IRC as a starting point for their own individual and corporate income tax regimes, and adopt statutory provisions, definitions, case law, and guidance by reference.⁵ Unfortunately, first the TCJA and then this year's Coronavirus Aid, Relief, and Economic Security (CARES) Act introduced a limitation in many states: the existence of static (or "fixed date") rather than rolling conformity, meaning that a state's tax system can be linked to the federal code as it existed at some past date.

² Charles McLure Jr., "Understanding Uniformity and Diversity in State Corporate Income Taxes," *National Tax Journal* 61:1 (March 2008).

³ 15 U.S. Code § 381.

⁴ Walter Hellerstein, "Federal-State Tax Coordination: What Congress Should or Should Not Do," Testimony before the U.S. Senate Committee on Finance, Apr. 25, 2012, <https://www.finance.senate.gov/imo/media/doc/Testimony%20of%20Hellerstein.pdf>.

⁵ Harley T. Duncan, "Relationships Between Federal and State Income Taxes," Federation of Tax Administrators, April 2005, http://govinfo.library.unt.edu/taxreformpanel/meetings/pdf/incometax_04182005.pdf.

Particularly in the wake of significant changes like the TCJA or CARES Act, this divergence can have significant consequences for taxpayers not just in greater complexity, but also in setting state and federal tax provisions at odds with each other. States should continue to move to rolling conformity, automatically adopting revisions to the IRC from which they do not expressly decouple or implement modifications.

State Reform #3: Stop States from Taxing Global Corporate Income

The modern workforce, moreover, is not only multistate but multinational, and if states wish to be competitive in attracting and growing multinational businesses, they should take the necessary steps to exclude international income from their tax bases. Until quite recently, states taxed international income only peripherally if at all, but that changed after enactment of the TCJA—ironically inasmuch as that legislation represented a retreat from federal claims to international income for tax purposes.

As part of the federal transition from a worldwide to a quasi-territorial tax system, certain guardrails were implemented as a defense against profit shifting. The Global Intangible Low-Taxed Income (GILTI) inclusion was picked up by many states, but as an expansion of the scope of their international taxation, not a withdrawal. The provision, not designed for state tax systems, loses its motive force there; it does little to discourage profit shifting, while the tax base is distorted within the context of state tax codes.⁶ Most notably, the federal government limits the provision to certain returns to investment in low-tax regimes through the mechanism of a credit for foreign taxes paid; no such provision exists at the state level, where difficulties in apportioning GILTI across states can also result in multiple taxation.⁷ State tax codes designed to promote economic recovery should exempt international income, which states were never meant to tax, and historically have not taxed.

State Reform #4: Repeal Burdensome Taxes Businesses Must Pay Regardless of Profitability

States should also use this time to clear out some of the detritus in their tax codes, and to replace taxes that unduly hamper economic growth. State taxes levied on a business's capital stock, local taxes on business personal property (machinery, equipment, inventory, and any other physical property that is not real property, defined as land and structures),⁸ and gross receipts taxes⁹ at either level of government are all imposed without regard to profitability or ability to pay, and tend to penalize investment. These taxes impair economic growth in the best of times, but during an economic contraction they are particularly harmful to businesses struggling to remain viable. As many businesses may take time to return to profitability after the crisis, states should prioritize reducing reliance on these taxes, particularly those that discourage capital investment, and shift toward more neutral forms of business taxation.

6 Jared Walczak and Erica York, "GILTI and Other Conformity Issues Still Loom for States in 2020," Tax Foundation, Dec. 19, 2019, <https://taxfoundation.org/gilti-state-conformity-issues-loom-in-2020/>.

7 Karl A. Frieden and Joseph X. Donovan, "Where in the World is Factor Representation for Foreign-Source Income?" State Tax Notes, Apr. 15, 2019; and Lee A. Shepard, "Is Taxing GILTI Constitutional?" State Tax Notes, July 30, 2018.

8 See generally, Garrett Watson, "States Should Continue to Reform Taxes on Tangible Personal Property," Tax Foundation, Aug. 6, 2019, <https://taxfoundation.org/tangible-personal-property-tax/>.

9 See generally, Justin Ross, "Gross Receipts Taxes: Theory and Recent Evidence," Tax Foundation, Oct. 6, 2016, <https://taxfoundation.org/gross-receipts-taxes-theory-and-recent-evidence/>.

State Reform #5: Fix Unemployment Insurance (UI) Systems to Prevent Tax Hikes

While businesses remain affected by the ongoing crisis, moreover, states should revise their unemployment insurance (UI) tax systems to prevent these taxes from spiking on businesses when they have the least ability to pay. While unemployment compensation funds are inadequately funded in many states, likely necessitating federal loans to cover claims, the priority should be ensuring that businesses remain viable and able to rehire laid off workers when the health crisis abates, not raising UI taxes immediately to replenish the depleted funds.

Because unemployment insurance operates as a system of social insurance, a business's history of layoffs—quantified in what is known as its “experience rating”—affects its rate of tax. Several states have already established that layoffs stemming from COVID-19 closure orders will not affect a business's experience rating and subject it to higher rates or are in the process of doing so.¹⁰ Other states would do well to follow their lead.

State Reform #6: Broaden Sales Tax Bases to Avoid More Harmful Tax Increases

An unusual feature of the present economic contraction also suggests a further reform to state tax codes, designed to enhance neutrality and reduce revenue volatility. State sales tax bases should be broadened to include a wider range of final consumption, both goods and services.

Historically, sales tax collections have proven far more stable than income taxes during recessions since taxable income drops much more precipitously than consumption when the economy is weak. Now, with stay-at-home orders and the closure of many nonessential businesses, consumption has declined dramatically as well, and with it, state sales tax receipts. Notably, the few categories of consumption which have defied the broader trend, like groceries and digital goods, are frequently exempt from the sales tax.

Grocery exemptions are well-meaning, intended to introduce progressivity into the sales tax by exempting purchases that comprise a larger share of low earners' total consumption. In practice, however, they not only carve a significant hole in sales tax collections, but substantially benefit higher earners as well, particularly since prepared foods—often favored by low-income working families—are taxed, while purchases made with SNAP and WIC benefits are already excluded from the tax base regardless of the broader tax treatment of unprepared foods. Taxing groceries but providing a refundable grocery tax credit to low-income families is much better targeted tax policy and would have benefited many states during the current crisis.¹¹ Broadening the sales tax base to include new forms of consumption, like personal consumption of digital goods and a range of services, is also sound tax policy.

10 Jared Walczak, “How the Federal Government and the States Could Help Save Small Businesses Through Temporary UI Tax Adjustments,” Tax Foundation, Mar. 17, 2020, <https://taxfoundation.org/save-small-businesses-temporary-unemployment-insurance-tax/>.

11 Steven M. Sheffrin and Anna Johnson, “Rethinking the Sales Tax Food Exclusion with SNAP Benefits,” State Tax Notes, Jan. 11, 2016, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2597228.

Clearing a Path on Federal Tax Policy

To be effective in promoting economic recovery, federal tax policies must focus on long-term reductions in the cost of capital. Temporary provisions will not provide adequate time to recoup the cost of major investments initiatives. Investments associated with shifting supply chains, in particular, may take a decade to complete even if they begin immediately.

Moreover, short-term fixes increase uncertainty, further discouraging capital spending and new investment, in general. To that end, the most essential step Congress and the Trump administration could take is to expand and make permanent the broad-based investment incentives contained in the Tax Cuts and Jobs Act.

Federal Reform #1: Prevent Tax Increases on Capital Investment and R&D

The TCJA contained a number of speed bumps in the path to long-term economic growth that lawmakers should clear away. One of the most economically important provisions in the TCJA was the allowance for the full expensing of new capital equipment which, unfortunately, is set to phase out beginning in 2022. This creates enormous uncertainty for businesses which need to make long-term capital investment decisions. Making expensing permanent policy would remove this uncertainty and ensure the continued growth in the nation's capital stock.

However, the full-expensing provision in the TCJA applied only to short-lived assets, such as equipment and machinery, and exempted buildings and structures. This incongruity means that businesses can write off new equipment, but they must depreciate the new factory or building the machinery is used in for as long as 39 years. Extending full-expensing treatment to all assets would make the U.S. a much more attractive place for manufacturing and export production.

Another TCJA speed bump in the future cost of business investment is a scheduled change in how the costs of research and development are treated. Currently, R&D expenses can be written off in the year in which they are made. Starting in 2022, however, businesses will have to amortize these costs over time, which will have the effect of raising taxes on the kinds of inventions and technologies the economy needs to recover and grow. This scheduled tax increase should be repealed.

In addition to providing an immediate uptick in investment, these three measures together—making permanent the full expensing of equipment, extending full expensing to structures, and repealing the requirement that R&D be amortized—would increase long-run GDP by over 5 percent and create roughly 1 million permanent jobs. This enduring increase in economic output and employment would reduce uncertainty and give consumers the confidence to increase consumption immediately, further accelerating the recovery.

Federal Reform #2: Expand Liquidity by Allowing Deductions to be “Cashed Out”

Incentives to invest will make little difference, however, if firms are unable to raise money upfront to make additional expenditures. The Federal Reserve is doing all it can to ensure that liquidity remains available in U.S. capital markets, but again in these challenging times it still may not be enough.

Subsidies and direct grants to businesses might appear to be an attractive remedy, but they put the government in the difficult position of having to pick winners and losers. Instead, Congress should allow businesses to “cash out” allowances for depreciation or net operating losses made in previous years. These are deductions companies have already earned but would normally not be able to apply to their tax liability until they returned to profitability. Allowing companies to accelerate those deductions provides them with additional cash flow to make investments today without requiring the federal government to decide which projects are worthy of aid.

Another option is to bring back the safe harbor leasing provisions that were included in the Economic Recovery Tax Act of 1981. Safe harbor leasing allowed struggling companies, such as manufacturers and airlines, to acquire the capital equipment they needed while giving the tax benefits of the investment to more profitable companies. This is a win-win for each party in the transaction.

Federal Reform #3: Remove the Tax Wedge from Borrowing Costs While Raising Revenue

Another tax increase scheduled in the TCJA is a change in how interest costs are deducted. Currently, business can deduct its interest expenses but this is limited to 30 percent of a company’s earnings before interest, taxes, depreciation, and amortization (EBITDA). Starting in 2022, this limitation is restricted even further to 30 percent of earnings before interest and taxes (EBIT), resulting in an increase in a company’s effective tax rate.

While lawmakers may want to consider preventing this scheduled tax increase, they should strongly consider a more forward-looking proposal to completely reverse how interest is treated in the tax code. Currently, borrowers can deduct the interest they pay on loans and corporate bonds and lenders are correspondently taxed on the interest income they receive. A more economically beneficial approach would reverse this treatment by prospectively removing both the deductibility and the taxability of interest.

There are a few problems that result from the current tax treatment of interest. First, the deductibility of interest gives borrowing a tax advantage over equity financing, which can lead to overleveraging. Second, many lenders—such as university endowments and foreign sovereign wealth funds—do not pay tax on their interest earnings, thus denying the U.S. Treasury of billions in potential taxes. Lastly, there is a tax premium, or wedge, built into interest payments because of the taxable nature of interest income. This raises interest costs.

Reversing the tax treatment of interest would mean that borrowers would no longer deduct the interest they pay on all new loans and bond issuances. Meanwhile, lenders would no longer be taxed on the interest income they receive.¹² This policy change solves each of the issues mentioned above.

First, denying the deductibility of interest payments puts debt and equity financing on equal footing, which will improve the allocation of investment during the economic recovery. Next, the denial of interest deductibility effectively taxes those currently untaxed lenders such as foreigners, which could mean a windfall for the Treasury. Finally, interest costs would fall by at least 21 percent, equal to the corporate tax rate. This would put corporate borrowing on par with municipal bonds.

Removing both the taxability and the deductibility of interest would contribute to a stronger tax system over the long term by removing the incentive for companies to use debt over equity financing during normal times and by making it more difficult for them to game international tax rules.

Federal Reform #4: Preventing a Needless Tax Increase on U.S. International Competitiveness

There is yet another ill-timed tax increase scheduled in the TCJA that lawmakers should remove in order to smooth the path to economic recovery for America's multinational firms. The Global Intangible Low Tax Income (GILTI) and the Base Erosion and Anti-abuse Tax (BEAT) were implemented to prevent two separate abuses: 1) generating income in low-taxed jurisdictions offshore, and 2) using deductible cross-border payments to decrease U.S. tax liability. Unfortunately, implementation has been less than smooth.

Both policies are scheduled to have rates increase in the coming years with the GILTI effective minimum rate increasing from 13.125 percent to 16.406 percent after 2025. Instead of allowing those rate increases to go as scheduled, reforms should be considered. The expense allocation feature of GILTI should be reformed so that the intended minimum tax rate on foreign income matches reality. BEAT should be reformed to more accurately target base-eroding payments. Both policies can be valuable to protecting the U.S. tax base, but their current construction and application is unnecessarily broad.

Federal Reform #5: Repeal the Tariff Tax Burden on American Consumers and Businesses

The recent tariffs should also be repealed. Tax Foundation economists estimate that these tariffs have amounted to one of the largest tax increases in recent U.S. history and have effectively clawed back as much as one-third of the economic benefits, including jobs, from the TCJA. Moreover, it is likely that the tariffs were already responsible for the downturn in manufacturing and capital spending that was evident before the COVID-19 outbreak brought the economy to a halt.

¹² See Alan Cole, "Interest Deductibility – Issues and Reforms," Tax Foundation, May 4, 2017, <https://taxfoundation.org/interest-deductibility/>; and Alan Cole, "Interest Treatment in the House GOP Tax Plan," Tax Foundation, July 1, 2016, <https://taxfoundation.org/interest-treatment-house-gop-tax-plan/>. Also, banks would be treated differently. They would be taxed only on the spread between their interest income and their cost of borrowing.

The Trump administration can send a strong signal to the rest of the world about its intentions to remove barriers to global trade by repealing these tariffs. As policymakers think through these complex issues, businesses should not be hampered by trade policy that was designed in the pre-pandemic era. The slate should be wiped clean and Congress should begin anew with a wholistic approach to securing Americans supply chains while maintaining the efficiency and productivity of U.S. industry.

Federal Reform #6: Improve the Tax Climate for a Flexible Entrepreneurial Economy

It's crucial that tax policy not stand in the way of the expansion of New Economy businesses that have proven invaluable during the pandemic. The so-called gig economy, for example, was hit hard by social distancing requirements, but it also provided essential delivery services that made those requirements practicable.

In general, New Economy firms have provided enormous flexibility for U.S. workers and businesses during the pandemic. As we look for ways to open the economy, New Economy firms have the potential to provide even more support not only in terms of flexibility but also in developing the kinds of health and public safety services the economy will need to reach its potential.

To that end, Congress should ease the tax compliance process for gig economy workers through streamlined deduction rules, modifications to quarterly estimated payments, and safe harbor provisions for gig economy firms to help their workers on tax issues.

A simplified expense deduction—modeled on other simplified deductions like the home office deduction or the vehicle miles traveled deduction—should be created to give gig economy workers an option to not itemize expenses in situations where that may complicate tax compliance.

Gig economy platforms should be permitted to voluntarily withhold income and self-employment tax on behalf of their workers in addition to providing tax guidance where appropriate under a safe harbor provision of existing labor law.

At the state level, discriminatory excise taxes on New Economy services should be repealed and states instead should focus on ensuring that the services are incorporated into state sales tax codes in a streamlined fashion.

In addition, lawmakers should reform the treatment of R&D tax credits for start-ups and entrepreneurs, with a focus on simplification and equal treatment of R&D expenses across firms. This could be done by expanding the use of the Alternative Simplified Credit¹³ and by allowing more start-ups to offset payroll tax liability with R&D credits. The latter policy contributed to tax neutrality by offsetting the penalty imposed on losses under current law.

13 The Alternative Simplified Credit is a four-step, and supposedly simpler, method of calculating a firm's research and development credit as opposed to the standard method. See Janet Berry-Johnson, "A Simple Guide to the R&D Tax Credit," Bench, Dec. 4, 2019, <https://bench.co/blog/tax-tips/rd-tax-credit/>.

Lastly, the treatment of R&D tax credit carryforwards should be reformed. Currently, these are limited for start-ups through Sections 382 and 383 of the tax code. The goal of these provisions was to limit tax harvesting but they have the unintended consequence of stopping start-ups with ongoing funding rounds from keeping all of their R&D tax credits and NOLs. The tax code should be modified so that start-up capital is exempted from the limitations imposed by sections 382 and 383.

Clearing a Path to Economic Recovery in International Tax Policy

Work by countries at the Organisation for Economic Co-Operation and Development (OECD) over the last decade has focused on plugging the gaps in the international tax system. That effort has now turned into a set of proposals that would shift where companies pay taxes and potentially increase taxes on digital companies by \$100 billion.

The global community should recognize that the digital project is not only leading to bad tax policies, but it is also prioritizing tax revenues over the need for economic growth. Over the past several years, countries have designed [unilateral digital taxes](#) that skirt tax treaties and lead to double taxation. The OECD (with direction from the G20) has responded not by working to eliminate those policies directly, but by coordinating an effort to increase taxes on digital companies worldwide.

Global Reform #1: Pause the OECD Digital Project Until Global Growth Rebounds

As priorities shift for governments around the world, the OECD should be willing to adjust the timeline and focus of its digital work and aim at supporting governments with tax policies promoting growth first, revenues second.

Instead of rushing toward a global digital tax solution in these challenging days, the OECD should pause these negotiations until the global economy has reached a stable growth path, say 2 percent annual growth for two consecutive years as measured by the World Bank or International Monetary Fund (IMF). Only in the context of a healthy global economy would further discussions of a global digital tax fix make sense.

Pausing the OECD program should be directly tied to a pause or delay in unilateral tax measures. If countries are unwilling to pause their unilateral digital tax efforts (which would face retaliatory trade measures), then a pause at the OECD level would likely lead to chaos. Countries should be willing to both pause the efforts at the OECD and avoid creating a new cross-border tax and trade war in the meantime.

Global Reform #2: Change the Mix of Taxes from Income to Consumption and Property

Seminal research by OECD economists has identified a useful hierarchy of how different tax policies impact economic growth.¹⁴ This hierarchy should guide countries as they craft tax policies to help their economies recover from the COVID-19 shutdown.

- **Corporate taxes** were found to be the most harmful taxes for economic growth because capital is the most mobile factor in the economy and, thus, most sensitive to high tax rates.
- **Individual income taxes**, including payroll taxes, were found to be the second-most harmful taxes for growth because of how they can retard work incentives and entrepreneurship.
- **Consumption taxes** were found to be less harmful for growth because they don't impact the incentives to work, save, and invest.
- **Taxes on immovable property** were found to be the least harmful for growth because, naturally, property can't be moved to avoid the tax.

Based on these guideposts, OECD research suggests that governments shift the mix of taxes away from income-based taxes to consumption and property taxes. Thus, the policy solutions for economic recovery and growth in countries around the world should include improving the tax treatment of capital investments and reducing direct taxes on workers. Countries should take this opportunity to restructure their revenue base to rely more on taxes that are less harmful to investment and growth and put effort into expanding consumption tax and property tax bases.

14 Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys, and Laura Vartia, "Tax and economic growth," OECD Economics Department Working Papers No. 620, July 11, 2008, <https://www.oecd.org/tax/tax-policy/41000592.pdf>. Also, Jens Matthias Arnold, Bert Brys, Christopher Heady, Åsa Johansson, Cyrille Schwellnus, and Laura Vartia, "Tax Policy for Economic Recovery and Growth," *The Economic Journal* 121:550 (February 2011), F59-F80, <https://academic.oup.com/ej/article-abstract/121/550/F59/5079707?redirectedFrom=fulltext>.

Conclusion

Reopening and rebuilding the economy as social distancing restrictions are relaxed will pose an unprecedented challenge. Major structural adjustments will have to take place to operate safely in the new environment. International supply chains will have to be rethought both to assure access to critical inputs as well as to adjust to the possibility that new coronavirus breakouts could occur in different parts of the world at different times.

At the same time, both businesses and households will be grappling with an enormous amount of uncertainty about the future. In this environment, lawmakers should resist the temptation to enact short-term policies that will, at best, act like a sugar-high and quickly wear off.

What businesses and individuals need is certainty about the future. Creating certainty does not necessarily mean a host of new policies, but instead clearing the path of tax policies that stand in the way of individuals and businesses getting back to work, investing in new plant and equipment, and shifting their lives to adapt to the new post-COVID-19 economy.

State lawmakers must identify and fix the tax measures in their codes that are incompatible with New Economy work and business models, as well as the tax measures that recovering businesses must pay regardless of their profitability.

Federal lawmakers can create certainty by making permanent the most growth-oriented provisions of the Tax Cuts and Jobs Act. This should include making full expensing permanent and extending this treatment to factories and buildings. Creating certainty also means repealing the tax increases scheduled under the TCJA and repealing the recent tariff tax increases. Lawmakers should also make the federal tax code friendlier to entrepreneurs, gig workers, and the platform companies that are reshaping the U.S. economy.

Ultimately, what businesses and individuals need is governments at all levels to coordinate their efforts to identify these tax policy speed bumps to economic recovery and work quickly to remove these barriers to long-term prosperity.