Joint Economic Committee
Representative Kevin Brady • Chairman

REPUBLICAN STAFF ANALYSIS

Bonus Depreciation

Closing the Growth Gap

May 28, 2014

Introduction

Making bonus depreciation permanent will help put the U.S. economy on a higher trajectory and begin to close the $1.4 trillion "Growth Gap" between our current recovery and the average of previous recoveries over the last five decades.

Without increased business investment in new buildings and equipment, economic growth and private-sector job creation will continue at the anemic pace that we have witnessed over the past 19 quarters of recovery. Over the same period, the average of other post-1960 recoveries saw real GDP expand at an annualized rate of 4.1% compared with this recovery's 2.2%. Similarly, while private sector payroll employment increased by an average of 12.6% in the 58 months after the recession ended in other post-1960 recoveries, it has only risen by 7.4% in the current recovery.

The bottom line is that faster growth in business investment generates faster private-sector job growth. As the Tax Foundation recently noted, "Investment increases the potential of our economy" by growing the capital stock which, in turn, boosts productivity and wages.[1] The Tax Foundation estimates that making 50% bonus depreciation permanent would expand the capital stock by more than 3%; increase the size of the U.S. economy by 1%; raise real wages by about 1%; and create 212,000 jobs. Moreover, making bonus depreciation permanent would actually increase federal revenues over the long run because of increased economic activity.[2]

Making bonus depreciation permanent will help close the "Growth Gap."

Without more business investment, our recovery will continue at an anemic pace.

A permanent 50% bonus depreciation would increase the capital stock by 3%, increase output by 1%, and create 212,000 jobs.

Depreciation, Expensing, and Neutral Cost Recovery

The federal tax code generally does not allow businesses to deduct all of the nominal cost of their investment in buildings and equipment in the same year when such investments are made.[3] Instead, the federal tax code requires businesses to deduct the nominal cost over several years or even decades. This system of gradual deductions through time is known as depreciation, whereas an immediate deduction is known as expensing.

The current depreciation system allows businesses to deduct the total cost of their investment in nominal terms—but not in real terms—because federal tax law does not adjust depreciation deductions for (1) price inflation and (2) the time value of money. A depreciation system that adjusts deductions for inflation and the time value of money is known as neutral cost recovery. By utilizing nominally fixed deprecation amounts, rather than expensing or neutral cost recovery, the federal tax code forces businesses to overstate their real income. This overstatement increases the cost of capital and reduces investment, employment, and economic growth.

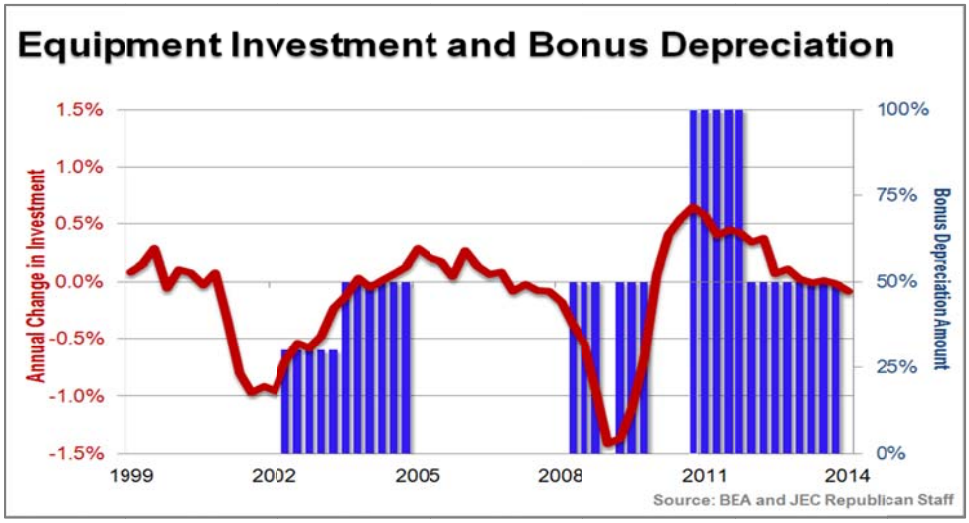
Bonus Depreciation

In recent years, Congress has enacted a series of temporary, partial expensing provisions known as bonus deprecation. These provisions have varied from 30 to 50 to 100 percent, thereby allowing businesses to immediately deduct a larger share of their investment. The table below shows the history of these various temporary provisions.

History of Bonus Depreciation Legislation

Legislation	Date of Enactment	Bonus Depreciation	Start	End
Job Creation and Worker Assistance Act of 2002 (PL 107-147)	3/9/2002	30%	9/10/2001	9/11/2004
Job and Growth Tax Relief Reconciliation Act of 2003 (PL 108-27)	5/28/2003	50%	5/5/2003	12/31/2004
-	-	0%	1/1/2005	12/31/2007
Economic Stimulus Act of 2008 (PL 110-185)	2/13/2008	50%	1/1/2008	12/31/2008
American Recovery and Reinvestment Act of 2009 (PL 111-5)	2/17/2009	50%	1/1/2009	12/31/2009
Small Business Jobs Act of 2010 (PL 111-240)	9/27/2010	50%	1/1/2010	12/31/2010
Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (PL 111-312)	12/17/2010	100%	9/9/2010	12/31/2011
		50%	1/1/2012	12/31/2012
American Taxpayer Relief Act of 2012 (PL 112-240)	1/2/2013	50%	1/1/2013	12/31/2013

The chart on the next page shows the annual change in private sector investment in equipment as a share of the economy.[4] It suggests the on again, off again, nature of these bonus depreciation provisions significantly limited their potential economic effects.

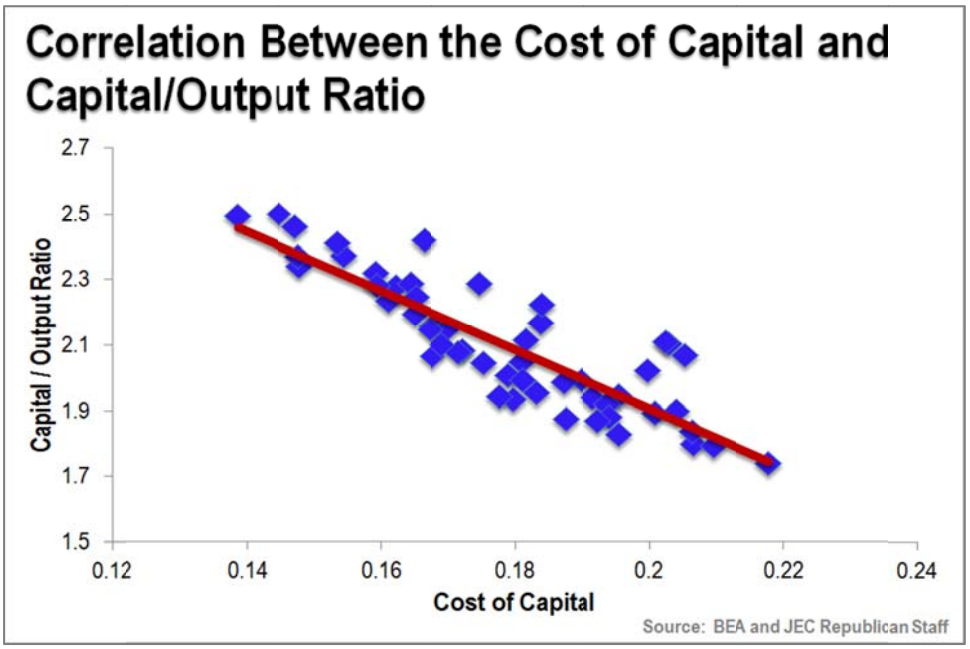


Temporary vs. Permanent

Temporary bonus depreciation provisions primarily affect the timing of investment. Businesses can either delay or speed up their planned investment in order to coincide with the effective date of the provision. Such timing shifts do not increase long-term investment. But a permanent bonus depreciation provision would reduce the cost of capital and increase the desired stock of physical capital over the long run.

The cost of capital is the gross return each additional unit of physical capital must earn in order to cover all of the costs associated with its use. These costs include: economic depreciation due to wear and tear or technological obsolescence; taxes on businesses and investors; and a normal rate of return.[5]

The chart below shows the correlation between the cost of capital and the stock of capital, measured as a share of business output.[6] When the cost of capital goes down, the capital stock goes up.



Conclusion

Previous efforts to provide temporary bonus depreciation have had only limited short-term effects on the U.S. economy. But a permanent extension would reduce the cost of capital and increase the capital stock. This would have long-term positive effects on investment, employment, and economic growth.

Endnotes

[1] See "Permanently Extending Bonus Depreciation Grows the Economy," at: http://taxfoundation.org/blog/permanently-extending-bonus-depreciation-grows-economy?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%253A+TaxPolicyBlog+(Tax+Foundation+-+Tax+Foundation%27s+%2522Tax+Policy+Blog%2522).

[2] The Economic and Budgetary Effects of Bonus Expensing, William Mc Bride, Tax Foundation, Fiscal Fact No. 428, April 2014, http://taxfoundation.org/sites/taxfoundation.org/files/docs/FF428.pdf.

[3] Under Section 179 of the Internal Revenue Code, expensing is allowed for eligible equipment up to $25,000 a year. Businesses with more than $225,000 in such investment are ineligible for Section 179.

[4] The chart shows the year-over-year percentage point change in the annualized quarterly data for gross private domestic investment in equipment, measured as a share of Gross Domestic Product. JEC Republican staff calculations based on data from the Bureau of Economic Analysis (BEA), http://www.bea.gov/iTable/index_nipa.cfm.

[5] Capital is defined as land, buildings, equipment, and inventories. The normal return is the amount investors expect to receive in order to forgo a dollar's worth of current consumption. It reflects the time-value of money or society's time preference. The cost of capital is also called the service price.

[6] The non-financial corporate business sector includes both C corps subject to the corporate income tax and S corps subject to the individual income tax. BEA does not distinguish between these two types of corporations, despite their different tax treatment. The chart is based on data from the Bureau of Economic Analysis (BEA), http://www.bea.gov/national/nipaweb/Ni_FedBeaSna/Index.asp.