

Economic and Budgetary Effects of Permanent Bonus Expensing

By Alan Cole
Economist

Key Findings

- Fifty percent bonus expensing allows all businesses to immediately deduct (expense) half of their investment in equipment and software, unlike the current depreciation system that delays these deductions for years or decades.
- Bonus expensing represents an important step toward full expensing, which economists recognize to be ideal for investment and economic growth.
- We find that extending 50 percent bonus expensing on a permanent basis would boost the long-term level of GDP by over 1 percent, the capital stock by over 3 percent, wages by about 1 percent, and would create 214,000 jobs.
- Due to the growth in wages and incomes, the ultimate cost to the treasury over ten years is less than a quarter of the revenue impact without growth.

The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

©2015 Tax Foundation
Distributed under
Creative Commons CC-BY-NC 4.0

Editor, Melodie Bowler
Designer, Dan Carvajal

Tax Foundation
1325 G Street, NW, Suite 950
Washington, DC 20005

202.464.6200

taxfoundation.org

Introduction

Congress is currently debating the tax extenders bill, which is a set of about 50 tax provisions that routinely expire and are then renewed again on a temporary basis. The tax extenders are currently expired for the calendar year of 2015, but they could be renewed at any time prior to the start of tax filing season. Not all of these are useful tax provisions worth keeping, but one of these—bonus expensing—stands out as an especially effective policy.¹

In contrast to many extenders that apply narrowly, resembling government spending programs, bonus expensing, also known as bonus depreciation, is broadly applicable and has the additional benefit of allowing businesses to more accurately report their incomes. These aspects, combined with its powerful growth effects, make bonus expensing the most helpful tax extender. Bonus expensing allows all businesses to immediately deduct a portion of investment expenses instead of the usual treatment that requires businesses to delay these deductions for years or decades based on a complicated system of depreciation by asset and industry.²

Bonus expensing allows 50 percent of investment in equipment and software to be deducted immediately (expensed), with the remainder deducted in the usual manner. Investment in structures or anything that is currently written off over more than 20 years is not included under this provision.

Over the years, Congress has been conflicted about the merits of bonus expensing, which may explain why it is often passed on a temporary basis. However, in recent years, both the Tax Foundation and the Joint Committee on Taxation (JCT) have done macroeconomic analysis of the provision, more clearly showing the benefits of the policy.³ We provide here the results from modeling a permanent extension of 50 percent bonus expensing.

Bonus Expensing Boosts GDP by Increasing the Capital Stock

Using our Taxes and Growth (TAG) Model to trace the effects of bonus expensing on the economy and the budget over the long run, we find that, made permanent, it would boost GDP by over 1 percent by the end of the budget period. The modification to cost recovery would increase the incentive to save and invest. The capital stock would increase by over 3 percent by 2025, making workers more productive. The higher productivity from capital deepening would raise wages by about 1 percent and create about 214,000 jobs.

1 Andrew Lundeen & Kyle Pomerleau, *Not All Tax Extenders Are Worth Extending*, TAX FOUNDATION TAX POLICY BLOG, Jan. 22, 2014, <http://taxfoundation.org/blog/not-all-tax-extendere-are-worth-extending>.

2 Stephen J. Entin, *The Tax Treatment of Capital Assets and Its Effect on Growth: Expensing, Depreciation, and the Concept of Cost Recovery in the Tax System*, TAX FOUNDATION BACKGROUND PAPER No. 67, Apr. 24, 2013, <http://taxfoundation.org/article-ns/tax-treatment-capital-assets-and-its-effect-growth-expensing-depreciation-and-concept-cost-recovery>.

3 Joint Committee on Taxation, *Macroeconomic Analysis for Bonus Depreciation Modified and Made Permanent*, July 15, 2014, <https://www.jct.gov/publications.html?func=startdown&id=4652>.

Table 1.
Economic Effects of Extending Bonus Expensing
on a Permanent Basis

| | |
|--|------|
| GDP | 1.1% |
| Private business stocks | 3.3% |
| Wage rate | 1.0% |
| Full-time equivalent jobs (in thousands) | 214 |

The federal budget would benefit as well. While the change in the taxable income base would reduce corporate income tax revenues—and, to a lesser extent, individual income tax revenue—these changes have important effects on the economy as a whole. Some of these, such as increased wages, are more important from a budgetary perspective than the deductions for business capital costs. As the economy grows and wages increase, higher income and payroll tax receipts substantially mitigate the revenue impact of the provision in the budget window. These results are shown in Table 2 (below).

Table 2.
Budgetary Effects of Extending Bonus Expensing on a Permanent Basis,
2015-2024 (in Billions of Dollars)

| Tax | Revenue Impact Due to Tax Changes | Revenue Impact Including Macroeconomic Effects |
|-------------------------|--------------------------------------|---|
| Individual Income Taxes | -68 | 65 |
| Payroll Taxes | 0 | 84 |
| Corporate Income Taxes | -268 | -241 |
| Excise Taxes | 0 | 7 |
| Other Revenues | 0 | 12 |
| Total | -336 | -74 |

These results have some similarities and some differences with the JCT macroeconomic analysis of the same policy provision. Using the Macroeconomic Equilibrium Growth (MEG) model, the JCT also found GDP growth from this measure due to higher investment:⁴

The proposal increases the expected after-tax return on investment in targeted depreciable property by allowing firms to deduct a larger share of their capital expenditures in the year of their purchase, relative to present law. This increase in after-tax returns on investment in business equipment and certain other depreciable property is expected to provide an incentive for an increase in savings and investment, resulting in an increase in business capital stock and the overall size of the economy, as measured by gross domestic product (“GDP”).

4 *Id.*

However, the MEG model finds a smaller effect than the TAG model. For example, the MEG model finds a 0.3% total increase in GDP by the end of the budget period, compared with a 1.1% increase in GDP from the TAG model. The most straightforward reason for this difference is that JCT expects that fewer businesses would be able to take advantage of the policy than the Tax Foundation does. JCT's analysis estimates that approximately 40 percent of investments will be eligible for the provision; the Tax Foundation puts that number closer to 70 percent.

There are also some differences in economic assumptions. For example, the MEG model has a substitution effect: the new investments from bonus expensing soak up capital that would have been used by other kinds of investments, such as housing. In contrast, the TAG model increases capital inflows from abroad, allowing the U.S. to invest in both.

No two economic models are exactly alike, but it is important to take notice when a consensus develops; both models predict that bonus expensing will increase the capital stock, wages, and GDP.

Conclusion

The public is best served by a stable, predictable tax code. The idea of tax extenders—of temporary provisions that exist in limbo—is not the stuff of sound tax policy. It makes sense, therefore, to decide once and for all which provisions are allowed to become permanent and which are allowed to expire.⁵ Bonus expensing is the best of these provisions. In a macroeconomic analysis of the extenders as a whole, JCT takes special note to mention expensing as the one that promotes growth.⁶

As the benefits of macroeconomic analysis make the benefits of this tax provision clear, the case for making it permanent grows ever stronger.

5 Alan Cole, *Tax Extenders: Take Them or Leave Them*, TAX FOUNDATION TAX POLICY BLOG, Nov. 25, 2014, <http://taxfoundation.org/blog/tax-extenders-take-them-or-leave-them>.

6 Joint Committee on Taxation, *A Report To The Congressional Budget Office Of The Macroeconomic Effects Of The "Tax Relief Extension Act Of 2015," As Ordered To Be Reported By The Senate Committee On Finance*, Aug. 4, 2015, <https://www.jct.gov/publications.html?func=startdown&id=4814>.