



The Daily Dish

Just a Tad More Neutral

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A signature of the One Big Beautiful Bill Act (OBBBA) was the permanent expensing of equipment investment and research and development costs. Expensing means the deduction of the full cost of the capital asset in the year of purchase. This stands in contrast to traditional depreciation - deducting a fraction of the asset's cost each year of the asset's life.

Why is this a big deal?

First, it is simpler. No need to keep track of the history of past depreciation, or even figure out the appropriate depreciation deduction. One and done. Simple.

Second, it transforms the tax to a cash-flow tax. This is especially helpful for new, start-up firms that are more likely to be purchasing a lot of capital and doing a lot of research. This makes the tax system a bit more pro-growth, and the United States needs all the growth it can get.

But most important, it makes the tax system more neutral. Is training workers the best way to raise productivity? Training costs are expensed. Is R&D the best way forward? It is expensed. Is a pay raise what the doctor ordered? Expense it. Need new computers and other equipment? They are expensed. Whatever was the right business decision in the absence of taxes remains the best decision in the presence of the tax system. That is the definition of tax neutrality, which is a benchmark of good tax policy. (This is why tax economists are not uniformly thrilled with OBBBA, which makes the system non-neutral between, for example, regular wages and overtime.)

So, with the passage of OBBBA, Eakinomics dragged out its old MISSION ACCOMPLISHED banner and popped open a Cab Franc.

Alas, not so fast. Much to Eakinomics' surprise, there remains a non-neutrality between self-

constructed assets and purchased assets. (Learn more about self-constructed assets in [this](#) pithy IRS publication.) Self-constructed assets typically take a year or more to construct and are built to use and not to be put in inventory. Examples are complex plants and equipment, fabrication machinery, data centers, long-distance cabling, and the like.

While the self-constructed assets are being built, they must be capitalized. Yet they are expensed once they are put into service. Notice, however, that if the asset were purchased from another firm, those costs of materials, labor, and overhead would be deducted (expensed) while the asset was being constructed, and the purchase would be expensed. This represents a tax-based bias against self-constructed assets.

This feels like a legacy of the old income tax treatment and a tax policy oversight not to have pursued this in OBBBA. It is also an opportunity to make the tax code a little more neutral.