Insight

Good Tax Policy during the Silly Season

GORDON GRAY | MAY 28, 2014

Comprehensive tax reform was always going to be an uphill battle – in the 100 plus years that the U.S. has had an income tax only a handful of overhauls have become law. So, as hopes for bipartisan and bicameral tax reform have given way to election-year messaging, it's easy to assume that the outlook for any positive development in tax policy is very dim indeed. One need only to look at the Senate to have this suspicion confirmed. Refusing to have Democratic Senators take tough votes in an election year, Majority Leader Harry Reid has let the extension of 50-plus temporary tax policies founder. Presumably, Majority Leader Reid would see these measures passed during a lame duck session.

Most of these tax policies are narrow in scope. A relative handful however hold real import for the economy at large – cost-recovery policy in particular. Enhanced cost recovery – also known as bonus depreciation or expensing (temporary or partial, depending on the specific design of the policy) – for business investment is sound policy that should be part of a pro-growth tax code.

On the House side, Congressman Pat Tiberi has introduced a bill that would make permanent a recently lapsed provision that allows businesses to immediately write-off, or expense, 50 percent of a qualified investment. The House Ways and Means Committee is reportedly going to consider this provision this week.

The approach being taken by the Ways and Means Committee contrasts markedly from the Senate Finance Committee's. The Senate passed a single measure, consisting of several dozen, temporary tax policies, that extended the provisions for two years. This largely mirrors the approach taken in the past to many of these provisions – short-term extensions for policies that have nominally been on the books for years. The Ways and Means Committee is taking a more deliberate approach by marking up individual and permanent extensions of select expired tax policies. The 50 percent expensing provision is one such lapsed tax law.

The economics of this provision are sound, particularly now. In the most recent GDP report, business fixed investment was a millstone on overall growth, pulling down overall GDP growth by 0.25 percentage points. While it is unclear if this is a general trend, at a minimum it suggests that the climate for business investment could be better. Accelerated cost recovery would contribute to that improvement. Indeed, one study estimated that a temporary partial 50 percent expensing policy would increase investment by 1.8 percent in the first quarter after enactment.

Past accelerated cost recovery policies, be they full or partial expensing, have been temporary and enacted as part of broader initiatives to spur economic growth. The temporary nature of the policies was deliberate and designed to shift future investment into the near-term to provide some form of "stimulus." However, to the extent that some form of expensing has been on the books for most of the 12 years since a partial expensing policy was enacted in 2002, it is debatable whether observers expect expensing provisions to be truly temporary. This diminishes the immediate "stimulus" effect, but augurs in favor of a more stable, permanent policy, in the vein of the Tiberi proposal. Over the long-term, one study found that a permanent 50 percent expensing policy would grow the economy GDP by over 1 percent and create over 200,000 jobs.

A wholesale overhaul of the tax code, to include rate reduction and international tax reform would be preferable to one-off reforms, and would bring the U.S. tax system more closely in line with other major economies. However, accelerated capital cost recovery, such as partial expensing would also address a specific U.S. competitive disadvantage: according to the Tax Foundation, the United States provides below-average investment incentives relative to other OECD nations.

The U.S. should work to address all of the deficiencies in the tax code. But failure to enact comprehensive reform should not preclude making permanent an important reform that could spur investment, growth, and address a significant international disadvantage in the U.S. tax code. In this sense, the Tiberi proposal is worth pursing singly, and on its own merits.