Tax Policy Center
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independent, timely, accessible analyses of current and emerging tax policy issues

Quick Facts: Bonus Depreciation and 100 Percent Expensing

1. What is the latest proposal?

On September 8, 2010, President Obama announced a new set of economic stimulus proposals, one of which involves extending and expanding the "bonus" depreciation rules enacted as part of both the 2008 and 2009 stimulus packages. Specifically, the President proposes extending the 50 percent bonus depreciation deduction for qualifying investment purchases made before September 8, 2010 and increasing it to 100 percent (i.e. full expensing) for purchases made between September 8, 2010 and December 31, 2011.

See Howard Gleckman, "Obama's Business Tax Cuts," *TaxVox*, September 7, 2010.
See also: White House Fact Sheet

2. What is bonus depreciation and how does it work?

To determine taxable income, businesses subtract expenses from their receipts. Some business expenses are for items that are entirely used up during the year (e.g., materials and labor), but other expenses are for durable goods that last for many years. The expense for investment in capital equipment (e.g., tractors, computers, and wind turbines) occurs over many years as the value of that investment is used up or depreciated. Under current law, businesses calculate taxable income by deducting capital costs over time according to fixed depreciation schedules.

Bonus depreciation allows for an additional deduction when the asset is first purchased. For example, a 50 percent bonus depreciation allowance would mean that businesses could immediately deduct 50 cents of every dollar spent on qualifying investment purchases. The remaining 50 cents would be deducted according to regular depreciation schedules.

The president's proposal takes that idea a step further and allows businesses to deduct immediately all of the costs of qualifying investment purchases.

3. What types of investment benefit?

Qualified investments include most business equipment and software, but not most structures. More specifically, qualified investments include tangible property with a recovery period of 20 years or less, water utility property, certain computer software, and qualified leasehold improvement property. In the aggregate, gross investment in equipment and software accounts for roughly 40 percent of all gross domestic investment

4. What types of businesses benefit?

All businesses qualify for the bonus depreciation deductions. However, there are several reasons why a business might see no benefit from increased depreciation allowances. For example, certain small businesses are already allowed to fully expense investment purchases under Section 179 of the IRS code. Additionally, the increased depreciation deductions provide immediate benefits only to businesses with positive taxable income (although firms with negative net income may be able to "carryback" increased losses and receive credits for previously paid taxes).

5. How much will it cost?

Accelerating depreciation deductions does not increase the total amount a company can write off for a given investment. Instead, it allows businesses to deduct more of the cost now and less in the future. That reduces their current taxes at the cost of higher taxes later. The Administration estimates that its proposal will reduce revenues by approximately $200 billion in fiscal years 2011 and 2012, but by "only" $30 billion over ten years.

6. Why does this sound familiar?

Temporary bonus depreciation incentives have been enacted frequently in recent years. In 2002, Congress let businesses claim a bonus depreciation allowance equal to 30 percent of the cost of investment purchased between September 10, 2001, and September 11, 2004. The following year, Congress raised the deduction to 50 percent of investments purchased between May 5, 2003 and January 1, 2005. The 2008 economic stimulus package renewed the 50 percent deduction again, this time for investments made during 2008. The American Recovery and Reinvestment Act of 2009 renewed the 50 percent deduction for investments made during 2009. The President's 2011 Budget proposed extending the 50 percent deduction for 2010.

Summary of Recent "Temporary" Bonus Depreciation Legislation

Legislation	First Year Bonus Depreciation	For Investment Purchased Between
Job Creation and Worked Assistance Act of 2002	30%	09/10/2001 - 09/11/2004
Jobs and Growth Tax Relief Reconciliation Act of 2003	50%	05/05/2003 - 12/31/2004
Economic Stimulus Act of 2008	50%	01/01/2008 - 12/31/2008
American Recovery and Reinvestment Act of 2009	50%	01/01/2009 - 12/31/2009

7. Is it an effective form of economic stimulus?

Providing temporary increases in depreciation allowances for certain equipment and software investment has become a staple of economic stimulus proposals. More generous depreciation deductions reduce the after-tax cost of investing, encouraging higher levels of investment spending by taxable businesses. The temporary nature encourages firms to accelerate otherwise planned investment spending forward when the economy is in most need. Furthermore, by merely changing the timing of tax deductions, bonus depreciation can deliver a large short-term "bang" for a relatively low long-term "buck."

However, economic research suggests that bonus depreciation enacted in 2002 and 2003 had relatively modest effects (CBO 2008). There are at least three reasons why: Businesses may have expected that Congress would extend the provisions, thus blunting their incentive to speed up investment. It takes time for businesses to make major investments, making it hard to fit them into specified time periods. Finally, many businesses may have had too little income to offset with these additional tax benefits, a problem that is especially acute during economic downturns.

As recent history has made clear, Congress can turn bonus depreciation on and off as economic circumstances dictate. Paradoxically, that flexibility could render the policy less effective. If businesses expect that Congress will extend the provision as it has in the past, they may not accelerate their investment. As a result, the benefits of the provision may accrue primarily to investment that would have been made anyway, thereby undercutting the cost effectiveness of the tax incentive.

The temporary nature of the provision increases its strength as a stimulus but necessarily reduces its long-run impact. Expiration of bonus depreciation raises a firm's net cost of new investment back to its previous level and removes any further incentive to invest now rather than later. In fact, because the provision primarily leads businesses to move their investment up in time and not to increase overall investment, it may lead businesses to reduce investment when the provision expires. If the economy is still in recession at that point, this could be especially undesirable.

When TPC graded the key tax provisions of the American Recovery and Reinvestment Tax Act of 2009, we gave the extension of bonus depreciation a "C."

See Tax Policy Center's Report Card on the 2009 Stimulus Bill: Extension of Bonus Depreciation
See Gene Steuerle, "Some Ignored Costs of Bonus Depreciation," Tax Notes, March 3, 2008

Additional Resources
Options for Responding to Short-Term Economic Weakness, Congressional Budget Office, January 2008