June 23, 2010

RE: Temporarily Extending the Bonus Depreciation Allowance

Dear New England Senator:

The President's Fiscal Year 2011 spending plan proposes the permanent extension of the "research and development" tax credit to stimulate investment in research and development "by providing certainty that the credit will be available for the duration of the investment."

The President has also asked Congress to extend for another year the increased capital equipment depreciation allowance, also known as the bonus depreciation allowance, along with the increased expensing of certain depreciable business assets, the increased "section 179 small business capital expense deduction."[1] Overall, these provisions generate tax relief for businesses in order to improve current market conditions.[2]

The "Hiring Incentives to Restore Employment (the 'HIRE') Act" (P.L. 111-147), enacted on March 18, 2010, temporarily extended the increased section 179 small business capital expense deduction. And the "American Jobs and Closing Tax Loopholes Act of 2010" (H.R. 4213), passed by the House last month and currently under consideration by the Senate, contains language temporarily extending certain tax expenditures expiring at the end of 2009, including a one-year extension for the research and development tax credit to help American businesses spur innovation and grow.[3]

[1] A special phase-out provision effectively targets the section 179 deduction to small businesses and generally eliminates it for larger businesses.

[2] In an effort to encourage business purchasing in 2009, the American Recovery and Reinvestment Act (ARRA) extended the capital investment incentives of the 2008 Economic Stimulus Act (i.e., the bonus depreciation allowance and increased section 179 small business capital expense deduction). Both provisions expired at the end of 2009. The Administration believes that "by accelerating in time the recovery of investment costs, the additional first-year deduction for new investment lowers the after-tax costs of capital purchases. This encourages new investment and promotes economic recovery." See, Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals," February 2010, p. 9.

[3] While often referred to as the "tax extenders" bill, the legislation may address other issues as well, including an extension of federal unemployment benefits beyond the current June 2010 expiration date.

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Neither the HIRE Act nor H.R. 4213, though, includes language to temporarily extend the bonus depreciation allowance - tax relief that encourages all businesses, regardless of size or research and development capabilities, to make timely capital investments that will further stimulate our economic recovery. However, earlier this week, a bipartisan stand-alone bill, S. 3513 “The Bonus Depreciation Extension to Create Jobs Act,” was introduced by Senators Baucus and Grassley to extend bonus depreciation allowance through 2010. We urge you to adopt this provision, either as recently introduced or by amendment to existing legislation that is moving through both branches, and to enact the same as soon as possible.

One of the remaining difficulties of the recession is that it is difficult for many businesses to access the capital they need to operate, grow, and create new jobs. Normally, businesses recover the cost of equipment and other capital investments through depreciation deductions spread evenly over several years. The bonus depreciation allowance provides a higher amount of depreciation earlier in the process. This tax incentive stimulates investments in tangible equipment and other property in the near term by enabling businesses to write off their cost more quickly.

Specifically, the Internal Revenue Code allows businesses to recover the cost of capital expenditures over time according to a depreciation schedule. In 2008, and again last year, Congress temporarily allowed businesses to recover the costs of capital expenditures made in 2008 and 2009 faster than the ordinary depreciation schedule would allow by initially deducting 50% (increased from 30%) of the cost of depreciable property (50% of the adjusted basis of qualified property, e.g., new equipment, tractors, wind turbines, solar panels, and computers) acquired during those two years for use in the United States.[4]

Thus, by reducing the first year’s tax bill for major capital purchases, the bonus depreciation allowance encourages companies to make these investments, with the savings generated used to keep employment levels stable.[5]

That this provision would be temporary and expire at the end of 2010 presents a sound business reason for the prompt investment and service placement of qualifying equipment

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[4] As provided by Congress within the Economic Stimulus Act of 2008, this 50% temporary bonus depreciation allowance initially applied to assets purchased and placed in service during the 2008 calendar year. The incentive was extended for an additional year under ARRA in 2009, meaning that the increased first-year depreciation deduction lasted until December 31, 2009. In other words, the bonus depreciation allowance applied to property purchased and placed in service after December 31, 2007, and before January 1, 2010.

[5] For purposes of the bonus depreciation allowance, qualified property was defined to include tangible property with a MACRS recovery period of 20 years or less, water utility property, certain computer software, and qualified leasehold improvement property.

and property, resulting in job growth and providing an immediate boost to our economy. The short-term investment response is greater for temporary than permanent tax incentives, because temporary tax incentives lead firms to shift investment forward from future years, but only if companies know it will be available when planning their 2010 investments.

Data released by the Bureau of Economic Analysis in late January supports this conclusion, indicating that business investments in equipment and other capital increased in the last two quarters of 2009 after a year and a half of decline.

In fact, economists have rated the bonus depreciation allowance as one of the most economically productive of economic stimulus initiatives. In a 2001 analysis, the Institute for Policy Innovation estimated that every $1 of tax cuts devoted to accelerated depreciation generates about $9 of GDP growth. In a 2006 study, House and Shapiro estimated that 30% bonus depreciation allowance in 2002 and 50% bonus depreciation allowance in 2003 may have resulted in the creation of 100,000 – 200,000 new jobs. The impact in 2010 of the 50% bonus depreciation allowance, coming out of a deeper recession, particularly when business investment is expected to be the driver of the recovery, is likely to be higher.

It is for those reasons that some 41 national business associations recently expressed their support for further extending the bonus depreciation allowance. With unemployment hovering close to 10%, and given the proven economic benefits resulting from the types of business activity generated from this tax incentive, it is sound public policy to extend it for another year.

Please do not hesitate to contact me if you have any questions.

Very truly yours,

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