Section 179 Expensing and the Bonus Depreciation Allowance: Their application, history, costs, and benefits.

Alice E. Keane, Governors State University

Available at: http://works.bepress.com/alice_keane/1/
Section 179 Expensing and the Bonus Depreciation Allowance: Their application, history, costs, and benefits.

By Alice E. Keane

I. Introduction

Virtually every year, Congress must decide whether to extend certain tax benefits for the current and coming fiscal years in an attempt to stimulate the economy. Over the past several years, two such provisions, Section 179 expensing and the bonus depreciation allowance, both of which allow businesses to accelerate the depreciation of certain types of property placed into service that year to provide increased current year deductions, have been repeatedly enacted for short terms, frequently retroactively. This paper provides an explanation of how these provisions work, their history and current legislation designed to extend them, and different analyses of their usefulness in stimulating the economy.

Giving businesses the opportunity to deduct the cost of equipment and other tangible personal property in the year in which they put it into service can be an incentive to increase investments in this type of property. Normally, businesses must deduct the cost of property over the course of years. However, the deductions allowed through Section 179 expensing and the bonus depreciation allowance provide certain businesses investing in certain types of property with the opportunity to deduct all or dramatically more of the cost of this property in the fiscal year in which it is placed in service.

1 Alice E. Keane received her LL.M. in taxation from Georgetown University Law Center in 2003 and her J.D. from the University of Illinois College of Law in 1993. She currently works as an adjunct professor in the College of Business and Public Administration at Governor’s State University in University Park, Illinois and is the Supervisor of the Civil Prosecutions and Administrative Law Unit in the General Law Bureau of the Illinois Attorney General’s Office. Opinions expressed in this article are solely Ms. Keane’s and should not be attributed to the Illinois Attorney General’s Office.

2 26 USCA 179.

3 26 USCA 168(k).
The Section 179 expensing and bonus depreciation allowance are frequently lumped together in discussions of tax incentives. They provide, generally speaking, the same benefit—the opportunity to take accelerated deductions in certain property. However, they are different, both in effect and in application.

Both of these deductions expired in 2014. Congress is currently considering the extension of both for 2015 and beyond as a means to stimulate the continuing sluggishness in the economy. However, there is conflicting evidence as to whether accelerated deductions actually stimulate the economy during times of limited growth. In addition, the delay in the enactment of these deductions during the applicable taxable year in past years, and currently in 2015, creates uncertainty in the business community that limits any incentive to invest and instead creates a mere windfall for companies that do invest. Extending the bonus depreciation allowance, in particular, is highly controversial.

II. How Section 179 expensing and the bonus depreciation allowance work.

Section 179 expensing and the bonus depreciation allowance allow taxpayers to take greatly accelerated income tax deductions for the cost of and investment in certain types of business and income-producing property purchased and put into service during the year. Absent Section 179 expensing and the bonus depreciation allowance, tangible business and income-producing property must be depreciated over the span of a number of years, depending on the type of property, through yearly deductions taken from the taxpayer's basis in the property.4

---

4 26 USCA 168(b).
Depreciation deductions are designed to reduce the basis of property that has a useful life of more than one year\(^5\) for the wear and tear, deterioration, or obsolescence as it diminishes in value year by year.\(^6\) Without Section 179 expensing and the bonus depreciation allowance, deductions for most types of property owned by businesses are limited to the yearly amounts allowed under the Modified Accelerated Cost Recovery System or "MACRS."\(^7\) The Internal Revenue Code establishes categories of property that are depreciated over varying numbers of years based on the anticipated life span of the property.\(^8\) Under MACRS, most tangible personal property is depreciated under the General Depreciation System, also known as the double (or 200%) declining balance method.\(^9\)

Section 179 expensing and the bonus depreciation allowance provide taxpayers with the opportunity to greatly accelerate their deductions in certain types of business and income-producing property over the deduction amounts allowed under MACRS. The use of both of these deductions is optional.\(^10\)

**A. Section 179 Expensing**

Under Section 179, a taxpayer can elect to treat the cost of any qualified property as an expense that is not a capital expenditure.\(^11\) In other words, the cost of the property is immediately deductible to the purchaser for the taxable year in which it is placed into service rather than having to be depreciated over a period of years.

---

\(^5\) Land, certain excepted property, and property retired from service cannot be depreciated. Department of the Treasury, Internal Revenue Service, Publication 946, *How to Depreciate Property*, February 27, 2015, pp. 6-8 ("IRS Pub. 946").

\(^6\) IRS Pub. 946, p. 6.

\(^7\) *See generally* 26 USCA 168; IRS Pub. 246, pp. 30-54.

\(^8\) 26 USCA 168(e); IRS Pub. 246, pp. 31-32.

\(^9\) 26 USCA 168(b); IRS Pub. 246, pp. 31-34.

\(^10\) IRS Pub. 246, pp. 15, 29.

\(^11\) 26 USCA 179(a).
Section 179 applies to certain types of property purchased from unrelated persons for use in a trade or business.\textsuperscript{12} It includes tangible personal property like machinery and equipment, property contained in or attached to a building other than structural components (like grocery store counters, refrigerators, printing presses, office equipment), gasoline storage tanks and pumps at retail gas stations, livestock, and off-the-shelf computer software.\textsuperscript{13} It also can be used for certain types of real property (qualified leasehold, restaurant, or retail improvement property), though with a lower limit for expensing.\textsuperscript{14}

The Section 179 deduction is generally allowed up to the full amount of the cost of the property.\textsuperscript{15} However, the deduction is limited by a dollar amount\textsuperscript{16} and is phased out dollar for dollar when the total amount of the taxpayer’s basis in qualified property reaches the threshold for phasing out the deduction ("phaseout threshold").\textsuperscript{17} Though Section 179 expensing is not expressly limited to small or mid-sized businesses, as a practical matter, because of the phaseout threshold, only small and mid-sized businesses can take advantage of it.

As discussed above, Section 179 expensing is still in existence in 2015; however, the monetary limits on the expensing are far lower than they were for property put into service in 2014.\textsuperscript{18} Under current law, the Section 179 limit is $25,000 and the phaseout threshold is $200,000.\textsuperscript{19} In contrast, in 2014, a taxpayer was entitled to expense up to $500,000 of qualified property placed in service that year with a phaseout threshold of $2

\begin{itemize}
  \item \textsuperscript{12} IRS Pub. 946, p. 16.
  \item \textsuperscript{13} 26 USCA 179(d)(1).
  \item \textsuperscript{14} 26 USCA 179(f).
  \item \textsuperscript{15} 26 USCA 179(a).
  \item \textsuperscript{16} 26 USCA 179(b)(1).
  \item \textsuperscript{17} 26 USCA 179(b)(2).
  \item \textsuperscript{18} 26 USCA 179(b)(1)(C).
  \item \textsuperscript{19} 26 USCA 179(b)(1)(C), (2)(C).
\end{itemize}
million.\textsuperscript{20} For instance, if a taxpayer purchased machinery for $475,000, tools for $50,000, and office furniture for $10,000 in 2014, for a total of $535,000, the taxpayer could have elected the Section 179 expensing in different amounts for each purchase up to a total of $500,000. If the taxpayer elected to expense $10,000 for the office furniture, $50,000 for the tools, and $475,000 for the machinery, the taxpayer could take the full $500,000 Section 179 deduction on her 2014 tax return. Her basis in the office furniture and tools would then be $0, but she would still have a $25,000 basis in the machinery for which she could take depreciation under either a combination of the bonus depreciation allowance and MACRS or MACRS alone. The MACRS depreciation amount would be based on the MACRS tables in the current year and going forward.

In addition, if the taxpayer placed into service qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) during 2014, she could elect to use $250,000 of the $500,000 maximum deduction for that property.\textsuperscript{21}

If the total cost of qualifying property exceeds a certain amount, the deduction under Section 179 decreases dollar for dollar over the phaseout threshold.\textsuperscript{22} For example, if a taxpayer purchased $2.2 worth of qualifying property in 2014, when the phaseout threshold was $2 million, she could only take a Section 179 deduction up to $300,000 because the total cost of the qualifying property was $200,000 over the minimum phaseout threshold. ($500,000 - $200,000 = $300,000) Once her total purchases exceeded $2.5 million, no Section 179 expensing would be available.

\textsuperscript{20} 26 USCA 179(b)(1)(B), (2)(B).
\textsuperscript{21} 26 USCA 179(f)(3).
\textsuperscript{22} 26 USCA 179(b)(2).
The total amount that a taxpayer can deduct in a tax year is limited to the taxable income from the active conduct of a trade or business in that year. If the Section 179 deduction is greater than this income in the year in which the property is placed into service, the excess can generally be carried over as a deduction to a later tax year, subject to certain limitations.

**B. The bonus depreciation allowance**

The bonus depreciation allowance is different from Section 179 expensing in ways that make it more useful for businesses with larger investments in qualified property. Unlike Section 179 expensing, the bonus depreciation allowance is not limited in amount and has no phaseout threshold. Instead, it allows the taxpayer to immediately depreciate and take as a deduction a certain percentage of the qualified property's basis in the current year. The percentage that could be depreciated has ranged from 30% to 100% in the years in which the allowance has applied. In 2014, the bonus depreciation allowance provided a deduction of 50% of the basis on qualifying property that a taxpayer could take in the year in which it was placed into service after taking the Section 179 deduction and before figuring any regular depreciation under MACRS. If the taxpayer's total basis in qualified property placed in service in the tax year exceeded $2.5 million, the bonus depreciation allowance would still allow the taxpayer to depreciate the qualified property by 50%, plus the depreciation amount allowed under MACRS.

Because the allowance is not limited by amount, it can be used by both small and large

---

23 26 USCA 179(b)(3).
24 26 USCA 179(b)(3)(B).
25 26 USCA 168(k).
26 26 USCA 168(k)(1)(A).
27 26 USCA 168(k)(1)(A), (B); IRS Pub. 946, p. 28-29.
businesses. This allowance has not yet been reenacted by Congress for 2015 at this writing.

In general, bonus depreciation can be used on the same categories of property as qualified property under Section 179, with the exception of used property which is eligible for Section 179 expensing. In 2014, qualified property included: (1) qualified reuse and recycling property, which is any machinery and equipment, and the software necessary to operate that machinery and equipment, that is used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials; (2) qualified second generation biofuel plant property, used in the U.S. solely to produce second generation biofuel; and (3) certain qualified property acquired after December 31, 2007, which is tangible personal property depreciated under MACRS with a recovery period of 20 years or less, water utility property, certain computer software, and qualified leasehold improvement property. For the third category of property, it must have been acquired after December 31, 2008 and placed into service before January 2015, with certain exceptions.

In 2014, C corporations could also elect to accelerate alternative minimum tax ("AMT") credits and research credits in lieu of using the bonus depreciation allowance for eligible qualified property. These corporations could trade bonus depreciation allowances for property acquired in 2014 for a refundable accelerated tax credit up to the lesser of $30 million or 6% of the sum of any AMT credits carried forward from tax

---

28 26 USCA 168(k)(2).
30 26 USCA 168(k)(2), (3); IRS Pub. 946.
32 26 USCA 168(k)(4).
years before 2006. If elected, the corporation must depreciate the property using the straight-line method. Generally, because the bonus depreciation allowance has been reenacted frequently, the permanence of this election has been limited. Corporations have been allowed to change their election with each reenactment and the limitation amounts for this election have been applied separately to property subject to the election at each extension of the law.

C. Example

To demonstrate the operation of Section 179 expensing and the bonus depreciation allowance, the following example may be helpful.

John Smith owns as a sole proprietorship called Smith Manufacturing. He purchased and put into use new machine tools that had a purchase price of $700,000 and a recovery period of five years under the MACRS tables in February 2014. In May 2014, he bought new office furniture that had a purchase price of $10,000 and a recovery period of seven years. His total purchase of qualified property in 2014 was $710,000.

John decided to expense the entire purchase price of the office equipment and $490,000 of the machinery under Section 179, and therefore took the entire Section 179 deduction of $500,000 ($10,000 + $490,000). His purchases were also qualifying property for the bonus depreciation allowance. Because he had already taken a Section 179 deduction for the entire basis in the office furniture, he can only use the bonus depreciation allowance for the remaining basis in the machine tools, which was $210,000 ($700,000 - $490,000). The bonus depreciation allowance in 2014 was 50%, which allowed John to take a

\[ \text{Bonus Depreciation} = \frac{50\%}{2} \times (700,000 - 490,000) \]

\[ \text{Bonus Depreciation} = 25\% \times 210,000 = 52,500 \]

\[ \text{Total Depreciation} = 500,000 + 25,000 = 525,000 \]

---

33 Id.
34 26 USCA 168(k)(4)(A).
35 26 USCA 168(k)(4)(C)(iii), (H), (I), (J), and (K); Joint Committee on Taxation, Description of H.R. 2510, A Bill To Modify and Make Permanent Bonus Depreciation (JCX-120-15), September 16, 2015, p. 5.
36 For the MACRS tables see IRS Pub. 946, pp. 7-97.
deduction of $105,000 for the machine tools ($210,000 x 50%). The remaining basis in the machine tools after the Section 179 deduction and the bonus depreciation allowance was $105,000.

John also took a deduction for depreciation under MACRS. The recovery period for the machine tools is five years, which is depreciated using the double-declining balance method. Using the MACRS table for five year property using the half-year convention, John determined he could depreciate the remaining basis in the machine tools by 20%, for a depreciation deduction of $21,000 ($105,000 x 20%). The remaining basis in the machine tools is $84,000 ($105,000 - $21,000).

Therefore, the total deduction that John could take in 2014 by using Section 179 expensing, the bonus depreciation allowance, and depreciation under MACRS was $626,000 ($500,000 + $105,000 + $21,000).

In contrast, assuming Congress does not extend the 2014 Section 179 expensing limits and the bonus depreciation allowance in 2015, John would have a much lower depreciation deduction for the same purchases made in 2015. While Section 179 expensing is still available at much lower levels, he would not be able to use Section 179 expensing because his total expenditures for the year would exceed the maximum phaseout amount in 2015 of $225,000 ($25,000 + $200,000). Therefore, John would be limited to using the double declining balance depreciation method available under MACRS. Using the half-year convention, John would be able to take a depreciation deduction of $1,429 for the office equipment ($10,000 x 14.29%) and $140,000 for the machine tools ($700,000 x 20%), for a total depreciation deduction of $141,429 in 2015.

---

37 The use of the half-year convention and other conventions under MACRS is governed by the type of property purchased and/or the date of purchase of the assets to be depreciated and is beyond the scope of this article. For a description of the conventions used in depreciation, see IRS Pub. 946, pp. 37-38.
He would have a remaining basis of $8,571 in the office furniture ($10,000 - $1,429) and $560,000 in the machine tools ($700,000 - $140,000). He would then continue to depreciate the office furniture over the next seven years and the machine tools over the next five years.

The 2014 Section 179 expensing levels and 50% bonus depreciation allowance would provide John with $484,571 more in total depreciation deductions for qualifying property than he could take in 2015 ($626,000 + $141,429).

As an alternative, assume that Smith Manufacturing, Inc. is a large C corporation that placed in service qualifying property with a basis of $7.1 million in 2014. Because this amount exceeds $2.5 million, Smith Manufacturing, Inc. would not be able to use Section 179 expensing. Instead, it could elect to use the bonus depreciation allowance to immediately expense $3.55 million, 50% of the total basis, and then take the depreciation deduction for the property allowed under MACRS for that year. Alternatively, if Smith Manufacturing, Inc. had sufficient unused AMT credits, the corporation could have elected to claim these tax credits in lieu of bonus depreciation in 2014.

Therefore, as a practical matter, the bonus depreciation allowance is less important to small and midsized businesses that invest in smaller quantities of depreciable property and more important to larger businesses and C corporations. For businesses wishing to maximize deductions with total investments in qualified property in 2014 that were below or at the $500,000 limit, the bonus depreciation allowance would not be used at all. It only becomes usable after the Section 179 expensing limit is reached. As the total investment amount approaches the phaseout threshold, the usefulness of the bonus depreciation allowance increases. After the investment amount increases beyond
$2.5 million, the taxpayer is limited to using only the bonus depreciation allowance. Therefore, the greater the investment in qualifying property over the Section 179 limit, the more the taxpayer benefits from bonus depreciation.

III. The history of Section 179 expensing and the bonus depreciation allowance.

A. Section 179 expensing

Section 179 expensing is not a new idea. It was first added to the Income Tax Code in the Small Business Tax Revision Act of 1958.\footnote{P.L. 85-866, 72 Stat. 1606.} The original deduction was up to $2,000 for an individual and $4,000 for a married couple. It was intended to stimulate investments by small business and simplify tax accounting for these businesses.\footnote{Gary Guenther, The Section 179 and Bonus Depreciation Expensing Allowances: Current Law and Issues for the 114th Congress, Congressional Research Service, August 6, 2015, p. 5.} The expensing allowance was raised to $5,000 in the Economic Recovery Tax Act of 1981\footnote{P.L. 97-34, 95 Stat. 172.} ("ERTA"), which provided for a gradual increase in the allowance to $10,000 by 1986. This increase was overshadowed by the investment tax credit provided in ERTA, which provided greater tax savings than the expensing allowance, so few businesses used the allowance in this period.\footnote{Guenther at 5.}

The increase in the expensing allowance was postponed to 1990 by the Deficit Reduction Act of 1984.\footnote{P.L. 98-369, 98 Stat. 494.} However, the investment tax credit was repealed in the Tax Reform Act of 1986, so the number of businesses using the expensing allowance rose at this time.\footnote{Guenther at 5.}

In 1990, the expensing allowance rose to $10,000 and remained at that amount until 1993. On January 1, 1993, the allowance increased to $17,500 in the Omnibus
Budget Reconciliation Act of 1993\textsuperscript{44} ("OBRA93"). OBRA93 also created enterprise zones and empowerment zones in areas with high poverty rates, and in those zones businesses could claim a maximum allowance that was $20,000 higher than other areas, with a phaseout threshold that was twice as large.\textsuperscript{45}

The Small Business Job Protection Act of 1996\textsuperscript{46} again set a timetable for increases in the Section 179 expensing allowance; $18,000 in 1997; $18,500 in 1998; $19,000 in 1999; $20,000 in 2000; $24,000 in 2001 and 2002; and $25,000 in 2003 and thereafter. In 2000, the Community Renewal Tax Relief Act of 2000\textsuperscript{47} added "renewal communities" to the areas in which the increases in the expensing allowances could be used. Under this Act, businesses in enterprise and empowerment zones and renewal communities could claim an allowance that was $35,000 over the regular allowance.

After the terrorist attacks in on September 11, 2001, the Job Creation and Worker Assistance Act of 2002\textsuperscript{48} established the "Liberty Zone" in New York City near the site of the terrorist attacks that provided businesses in that area with the same enhanced Section 179 expensing allowance as enterprise and empowerment zones and renewal communities.\textsuperscript{49}

The Jobs and Growth Tax Relief Reconciliation Act of 2003\textsuperscript{50} ("JGTRRA") increased the allowance to $100,000 as of May 6, 2003. It also raised the phaseout threshold to $400,000 during that period, indexed the regular allowance and phaseout threshold for inflation in 2004 and 2005, and added off-the-shelf software for business

\begin{flushright}
\textsuperscript{44} P.L. 103-66; 107 Stat. 312.
\textsuperscript{45} Guenther at 5, n. 1.
\textsuperscript{46} P.L. 104-188, 110 Stat. 1755.
\textsuperscript{47} P.L. 106-554, 114 Stat. 2764.
\textsuperscript{48} P.L. 107-147, 116 Stat. 21.
\textsuperscript{49} Guenther at 6.
\textsuperscript{50} P.L. 108-27; 117 Stat. 752.
\end{flushright}
use to the list of personal property eligible for expensing during that time. In 2006, the expense allowance was set to return to $25,000. However, the American Jobs Creation Act of 2004\textsuperscript{51} ("AJCA") extended the changes to 2007.\textsuperscript{52}

The Gulf Opportunity Zone Act of 2005\textsuperscript{53} created the "Gulf Opportunity Zone" in the areas impacted by Hurricane Katrina. Among other things, it dramatically enhanced the expensing allowance for a wider range of qualified property purchased on or after August 28, 2005 and placed in service by December 31, 2007 and increased the allowance by up to $100,000 and the phaseout amount by up to $600,000 in this Zone.\textsuperscript{54}

The Tax Increase Prevention and Reconciliation Act of 2005\textsuperscript{55} extended the changes in the expensing allowance from the JGTRRA to 2009.\textsuperscript{56}

In 2007, the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Appropriations Act\textsuperscript{57} extended the allowance from the JGTRRA to 2010, increased the maximum allowance to $125,000 and the phaseout to $500,000 from 2007 to 2010, and indexed both amounts for inflation during that time.\textsuperscript{58} It also extended the increased allowance for the Gulf Opportunity Zone until 2008.\textsuperscript{59}

Through the Economic Stimulus Act of 2008\textsuperscript{60} ("ESA"), the allowance was increased to $250,000 and the phaseout threshold to $800,000 in 2008. Under that Act, the allowance and phaseout would reset to $125,000 and $500,000 in 2009 and 2010,

---

\textsuperscript{51} P.L. 108-357.
\textsuperscript{52} Guenther at 6.
\textsuperscript{53} P.L. 109-135.
\textsuperscript{54} Guenther at 6.
\textsuperscript{55} P.L. 109-222.
\textsuperscript{56} Guenther at 6.
\textsuperscript{57} P.L. 110-28.
\textsuperscript{58} Guenther at 6.
\textsuperscript{59} Id.
\textsuperscript{60} P.L. 110-185.

The Small Business Jobs Act of 2010 ("SBJA"), effective September 27, 2010, retroactively increased the maximum expensing amount to $500,000 and the phaseout threshold to $2 million for 2010 and 2011. The SBJA also provided that qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant property ("qualified real property") was subject to an expensing allowance of up to $250,000 of the annual cost of that property.

Under the Tax Relief, Unemployment Compensation Reauthorization, and Job Creation Act of 2010, effective on December 17, 2010, for 2012 the maximum allowance was supposed to be set at $125,000 and the phaseout threshold at $500,000. However, the American Taxpayer Tax Relief Act of 2012, enacted on January 2, 2013, retroactively increased the maximum expensing allowance to $500,000 and the phaseout threshold to $2 million for 2012 and 2013. It also made off-the-shelf software subject to the allowance in 2013 and extended through 2013 the $250,000 expensing allowance for qualified real property.

61 Guenther at 6.
62 P.L. 111-5.
63 P.L. 111-147.
64 P.L. 111-240.
65 Guenther at 7.
66 P.L. 111-312.
67 P.L. 112-240.
68 Guenther at 7.
On December 19, 2014, the Tax Increase Prevention Act of 2014\textsuperscript{69} retroactively extended the expensing allowance from 2012 and 2013 to 2014.\textsuperscript{70} In 2015, the expensing allowance and phaseout threshold returned to the amount set in early 2003, $25,000 and $200,000,\textsuperscript{71} though this may be increased if legislation pending in Congress is enacted.

\textbf{B. Bonus Depreciation Allowance}

The bonus depreciation allowance is much newer than Section 179 expensing. It was created in the Job Creation and Worker Assistance Act of 2002,\textsuperscript{72} enacted March 9, 2002. Initially, the allowance was equal to 30\% of the adjusted basis of new qualified property acquired after September 11, 2001, and placed in service by December 31, 2004.\textsuperscript{73} That deadline was extended by one year for property with MACRS recovery periods of 10 or more years and lengthy production periods, and for transportation equipment.\textsuperscript{74} The Jobs and Growth Tax Relief Reconciliation Act of 2003,\textsuperscript{75} on May 28, 2003, raised the allowance to 50\% for the adjusted basis for qualified property acquired after May 5, 2003 and placed in service before January 1, 2006, and continued the one year extension for certain property.\textsuperscript{76}

After 2005, the bonus depreciation allowance expired until it was renewed in the Economic Stimulus Act of 2008,\textsuperscript{77} on February 13, 2008. This Act provided a 50\% allowance for property acquired after December 31, 2007 and placed in service before

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{69} P.L. 213-295.
\item \textsuperscript{70} Guenther 7.
\item \textsuperscript{71} 26 USCA 179(b)(1)(C), (2)(C).
\item \textsuperscript{72} P.L. 107-147.
\item \textsuperscript{73} Guenther at 7.
\item \textsuperscript{74} Id.
\item \textsuperscript{75} P.L. 108-27.
\item \textsuperscript{76} Guenther at 7.
\item \textsuperscript{77} P.L. 110-185.
\end{itemize}
\end{footnotesize}
January 1, 2009.\textsuperscript{78} The Housing Assistance Tax Act of 2008,\textsuperscript{79} signed into law on July 30, 2008, provided an alternative to bonus depreciation for C corporations. These corporations could trade bonus depreciation allowances that they could otherwise claim for property acquired between April 1 and December 31, 2008 for a refundable accelerated tax credit equal to the lesser of $30 million or 6% of the sum of any AMT and research credits carried forward from tax years before 2006.\textsuperscript{80}

The American Recovery and Reinvestment Act of 2009,\textsuperscript{81} enacted on February 17, 2009, provided an extension of the 50% bonus depreciation allowance and the above described tax credit option for C corporations from tax years 2006 to 2009.\textsuperscript{82} The Small Business Jobs Act of 2010,\textsuperscript{83} on September 27, 2010, again retroactively extended the 50% bonus depreciation allowance to property acquired and placed in service in 2010.

The Tax Relief, Unemployment Compensation Reauthorization, and Job Creation Act of 2010,\textsuperscript{84} effective on December 17, 2010, increased the bonus depreciation allowance to 100% for qualified property acquired after September 8, 2010 and placed in service before January 1, 2012.\textsuperscript{85} It also created a 50% allowance for property acquired and placed in service in 2012 and again gave corporations the option to claim a refundable credit for unused AMT credits (but not research credits) carried forward from tax years before 2006 rather than a bonus depreciation allowance for qualified property acquired between January 1, 2011 and December 31, 2012.\textsuperscript{86}

\begin{thebibliography}{99}
\bibitem{note1} Guenther at 7.
\bibitem{note2} P.L. 110-289.
\bibitem{note3} Guenther at 7.
\bibitem{note4} P.L. 111-5.
\bibitem{note5} Guenther at 7.
\bibitem{note6} P.L. 111-240.
\bibitem{note7} P.L. 111-312.
\bibitem{note8} Guenther at 8.
\bibitem{note9} Id.
\end{thebibliography}
In the American Taxpayer Relief Act of 2012,\textsuperscript{87} enacted on January 1, 2013, Congress extended the 50\% bonus depreciation allowance and the refundable accelerated credit for unused AMT credits (but not research credits) carried forward from tax years before 2006 instead of bonus depreciation for qualified property acquired and placed in service in 2013 through the end of 2013.\textsuperscript{88}

On December 19, 2014, the bonus depreciation allowance from 2013 was extended retroactively through 2014 in the Tax Increase Prevention Act of 2014.\textsuperscript{89} As discussed below, legislation is currently pending that would again extend the bonus depreciation allowance.

\textbf{IV. Legislation in 2015.}

If Congress does not act to retroactively extend the higher limit and phaseout threshold, the Section 179 expensing allowance for 2015 will remain $25,000, with a threshold phaseout of $200,000.\textsuperscript{90} Similarly, if Congress does not retroactively enact legislation to provide it, the bonus depreciation allowance will not be available for property placed in service in 2015, with the exception of certain types of longer-lived and transportation property placed in service before the end of the year, which is available until December 31, 2015.\textsuperscript{91}

Legislation is pending in Congress to continue these depreciation allowances. On February 13, 2015, the House passed H.R. 636, which would permanently set the maximum Section 179 allowances at $500,000 and the phaseout threshold at $2 million.\textsuperscript{92}

\textsuperscript{87} P.L. 112-240.
\textsuperscript{88} Guenther at 8.
\textsuperscript{89} P.L. 213-295.
\textsuperscript{90} 26 USCA 179(b)(1)(C), (b)(2)(C).
\textsuperscript{91} 26 USCA 168(k)(2)(A)(iv).
\textsuperscript{92} Guenther at 9; see also https://www.govtrack.us/congress/bills/114/hr636.
Both of these amounts would also be indexed for inflation.\footnote{93}{Guenther at 9.} This bill would also make additional types of property permanently eligible for the Section 179 deduction, including qualified computer software, heating and air conditioning equipment, and qualified real property, and would remove the $250,000 limit on expensing this property.\footnote{94}{Id.} The Joint Committee on Taxation estimated that this bill would result in foregone revenue of $77.1 billion from fiscal years 2015 to 2025.\footnote{95}{Id.}

The House Ways and Means Committee also passed H.R. 2510 in September 17, 2015, which, among other things, would make 50% bonus depreciation allowance permanent.\footnote{96}{Joint Committee on Taxation, Description of H.R. 636, The “America’s Small Business Tax Relief Act of 2015,” JCX-12-15 (Washington: Feb. 3, 2015), p. 5.} It would also remove the requirement that qualified improvement property must be subject to a lease and that the improvement must be placed into service more than three years after the date the building was first placed into service.\footnote{97}{Id. at 7.} The bill also would make the election to increase the AMT credit limitation in lieu of bonus depreciation for C corporations permanent and limits it to the lesser of (1) 50% of the minimum tax credit for the first taxable year ending after December 31, 2014, or (2) the minimum tax credit for the taxable year allocable to the adjusted net minimum tax imposed for taxable years ending before January 1, 2015.\footnote{98}{Id. at 7.} The Joint Committee on Taxation estimated that the bill would result in foregone revenue of $222 billion from fiscal year 2016 to 2020 and $281 billion from fiscal year 2016 to 2025.\footnote{99}{Id. at 9.}
On August 5, 2015, the Senate Finance Committee reported to the Senate S. 1946, titled the "Tax Relief Extension Act," which would extend the Section 179 depreciation deduction levels and phaseout threshold available in 2014 to 2015 and 2016 and index these amounts for inflation.\textsuperscript{100} According to the Joint Committee on Taxation, this would result in foregone revenue of $8.2 billion from fiscal years 2016 to 2020 and $3.5 billion from fiscal years 2016 to 2025.\textsuperscript{101} It would also retroactively extend both the 50% bonus depreciation allowance to property placed in service in 2015 and the option for C corporations to monetize AMT credits from years before 2006.\textsuperscript{102} These extensions of the bonus depreciation allowance would result in foregone revenue of $22.2 billion in fiscal years 2016 to 2020 and $3.6 billion from fiscal years 2016 to 2025.\textsuperscript{103}

The effects on foregone revenue in the bill from the extension of the bonus depreciation allowance are far greater than the other parts of the proposal, which temporarily extends certain previously enacted tax incentives in the Internal Revenue Code.\textsuperscript{104} Based on a macroeconomic analysis conducted by the Joint Committee on Taxation, the bill as a whole is expected to result in foregone revenue of $96.7 trillion from fiscal years 2016 to 2020 and $86.5 trillion from fiscal years 2016 to 2025.\textsuperscript{105}

\textsuperscript{100} See https://www.govtrack.us/congress/bills/114/s1946.
\textsuperscript{101} 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 (JCX-107-15), August 4, 2015, p. 5.
\textsuperscript{102} Joint Committee on Taxation, "Description of the Chairman's Mark of a Bill to Extend Certain Expired Tax Provisions" (JCX-101-15), July 17, 2015, p. 50.
\textsuperscript{103} 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 (JCX-107-15), August 4, 2015, p. 5.
\textsuperscript{104} Id. at 5.
\textsuperscript{105} Id. at 5, 7.
The President has also requested a continuation and enhancement of the Section 179 expensing allowance.\textsuperscript{106} In his fiscal year 2016 budget request, he proposes to extend the limit and phaseout threshold from 2014 to 2015.\textsuperscript{107} In 2016, the limit would rise permanently to $1 million, and the phaseout threshold would be set permanently at $2 million.\textsuperscript{108} Starting in 2017, these amounts and the $25,000 limitation for expensing certain sport utility vehicles would be indexed for inflation.\textsuperscript{109} Off the shelf computer software would be permanently added to the list of qualified property, but improvements to leasehold and retail properties and restaurants would be removed from the list.\textsuperscript{110} The Treasury Department estimated that the proposal would result in foregone revenue of $71.0 billion from fiscal years 2015 to 2025.\textsuperscript{111} President Obama did not request a continuation of the bonus depreciation allowance.\textsuperscript{112}

V. Analyses of the Bonus Depreciation Allowance and Section 179 Expensing.

Accelerated depreciation, particularly through the bonus depreciation allowance, is highly controversial.\textsuperscript{113} Analysts in the non-partisan Congressional Research Service,

\textsuperscript{107} Guenther at 10.
\textsuperscript{108} Id.
\textsuperscript{109} Id.
\textsuperscript{110} Id.
\textsuperscript{111} Id.
\textsuperscript{112} Id.
an agency within the Library of Congress that provides policy and legal analysis to members of Congress, have determined that positive economic benefits of bonus depreciation allowance and Section 179 expensing are questionable at best. However, in an economic analysis conducted in 2014 that was not considered by the Congressional Research Service analysts, economists at Harvard University determined that the use of bonus depreciation by certain businesses during periods of recession is much higher than traditional economic models have determined it to be.\(^\text{114}\)

A. Guenther analysis.

Gary Guenther, an analyst in public finance for the Congressional Research Service, issued a report on August 6, 2015, discussing the potential impact of legislation extending the bonus depreciation allowance and Section 179 expensing.\(^\text{115}\) He posited that expensing, the most accelerated form of depreciation, reduces the cost of capital by lowering, sometimes considerably, the tax burden on returns on an investment.\(^\text{116}\) He stated that economists see Section 179 expensing and the bonus depreciation allowance as "a significant tax subsidy, especially since some firms were able to take advantage of both allowances in the same tax year."\(^\text{117}\) However, he asserted that economic analysts have found that expensing has a low stimulative effect on the economy during a recession.


\(^\text{116}\) Guenther at 1, 11.

\(^\text{117}\) Id. at 1.
or slow growth.\textsuperscript{118} He opined that, although over half of all C and S corporations claimed bonus depreciation from 2002 to 2004, it had a limited impact on the investment decisions of companies and therefore is not an effective tool for stimulating the economy.\textsuperscript{119} He also cited to various studies to support his thesis that accelerated depreciation would have "relatively little bang for the buck as a means of boosting economic activity."\textsuperscript{120} In reaching these conclusions, he relied on studies of the economic effects of the bonus depreciation allowances on corporations from 2002 to 2004.\textsuperscript{121} He did not cite to any studies specifically addressing the value of Section 179 expensing to small and mid-sized businesses.

Guenther also considered the economic efficiency of expensing under an income tax system.\textsuperscript{122} He determined that Section 179 expensing and the bonus depreciation allowance may distort the allocation of resources between qualified property and all other types of investment, which would result in economic inefficiencies by encouraging investment in qualified property beyond its inherent investment potential.\textsuperscript{123} While he admitted that no studies have been done on whether expensing has led to shifts in the size and composition of companies' capital, he argues that most of the investment benefited by expensing would have taken place anyway, based on anecdotal evidence.\textsuperscript{124} He asserts that, from an economic standpoint, tax incentives like expensing lessen efficiency and "may worsen the deadweight loss associated with the federal tax code."\textsuperscript{125} Guenther also criticizes the phaseout threshold in Section 179, because it may cause smaller companies

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{118} Guenther at 12.
\item \textsuperscript{119} Id. at 12-13.
\item \textsuperscript{120} Id. at 13.
\item \textsuperscript{121} Id. at 12-13.
\item \textsuperscript{122} Id. at 14.
\item \textsuperscript{123} Id.
\item \textsuperscript{124} Id. at 15.
\item \textsuperscript{125} Id.
\end{enumerate}
\end{footnotesize}
to limit their investment so that they can take advantage of the expensing allowance.\textsuperscript{126} He asserted that, while one of the goals of the expensing allowance is to simplify the cost and complexity of tax accounting for businesses, the rules governing its use make compliance with the tax laws more complicated.\textsuperscript{127}

\textbf{B. Gravelle analysis.}

Another analyst in the Congressional Research Service, Jane G. Gravelle, a Senior Specialist in Economic Policy, evaluated the economic and budgetary issues in the bonus depreciation allowance in 2014.\textsuperscript{128} Gravelle asserted that bonus depreciation is not a traditional "extender" because "[i]t was enacted for a specific, short-term purpose: to provide an economic stimulus during the recession."\textsuperscript{129} She defined "extenders" as tax provisions that are enacted for only a year or two and extended multiple times, either for the opportunity to evaluate them or because enacting them permanently would increase costs in budget projections.\textsuperscript{130} These provisions, however, are for all intents and purposes, permanent. In contrast, Gravelle asserts that the bonus depreciation allowance, though at that time it had been extended for seven straight years, had a specific, short-term purpose of fiscal stimulus during the recession.\textsuperscript{131} She argued that making the bonus depreciation allowance an extender would limit its efficacy because the temporary nature of bonus depreciation makes it, "in theory, a more effective fiscal stimulus than other investment incentives because it is in the nature of a fire sale."\textsuperscript{132} Further, she cited to studies

\begin{thebibliography}{99}
\expandafter\ifx\csname l@id\endcsname\relax\renewcommand{\@biblabel}[1]{\textsuperscript{#1}}\fi
\bibitem{126} Id. at 16.
\bibitem{127} Id. at 17.
\bibitem{128} Jane G. Gravelle, \textit{Bonus Depreciation: Economic and Budgetary Issues}, Congressional Research Service, July 7, 2014. Gravelle also considered how bonus depreciation affects the tax rate on equipment investing and compared bonus depreciation to other tax reform proposals.
\bibitem{129} Id. at 1.
\bibitem{130} Id.
\bibitem{131} Id. at 1, 5.
\bibitem{132} Id. at 5.
\end{thebibliography}
demonstrating that it had "little or no effect on business investment" and only a limited effect in stimulating the economy.\textsuperscript{133} Gravelle argued that extending it retroactively "would have windfall elements."\textsuperscript{134} She also compared the bonus depreciation allowance with Section 179 expensing, and asserted that Section 179 expensing is more limited in scope than the bonus depreciation allowance and has a much smaller cost.\textsuperscript{135} Gravelle determined that bonus depreciation does not appear to be effective in providing a short-term stimulus in comparison to alternatives.\textsuperscript{136} She compared the revenue loss from extending bonus depreciation for one year to extending Section 179 expensing for two years; extending bonus depreciation for one year was expected to cost twice as much as extending Section 179 expensing for two years.\textsuperscript{137} She also considered the cost of extending both provisions permanently, which was expected to cost $346.1 billion dollars from 2014-2023.\textsuperscript{138} Gravelle estimated that the extension of bonus depreciation would account for approximately 90\% of that amount.\textsuperscript{139}

C. \textit{Zwick and Mahon analysis.}

In 2014, two economists at Harvard University, Eric Zwick and James Mahon, considered the effect of the bonus depreciation allowance, and in a more limited way, Section 179 expensing, on equipment investing by businesses to determine whether it spurs growth in times of economic weakness.\textsuperscript{140} Neither Guenther nor Gravelle cited to this study in their reports, though it has been relied upon by the Joint Committee on

\textsuperscript{133} Id. at 5-6.
\textsuperscript{134} Id. at 7.
\textsuperscript{135} Id. at 3, n. 6; 13-14.
\textsuperscript{136} Id. at 6.
\textsuperscript{137} Id. at 13.
\textsuperscript{138} Id. at 14.
\textsuperscript{139} Id. at 14.
\textsuperscript{140} Zwick at 2.
Taxation in reports to Congress. However, this study provides evidence that directly contradicts both Geunther and Gravelle's conclusions that bonus depreciation and Section 179 expensing do not have a positive effect on the economy during recession.

In contrast to prior studies that assumed "perfect capital markets," that is, "frictionless" markets where the players are not driven by outside incentives and disincentives, Zwick and Mahon included "financial frictions" -- high cost external financing and "managerial myopia" -- that cause companies to apply "implausibly high discount rates" to their investment decisions. They analyzed two million corporate tax returns from over 120,000 public and private companies from the Statistics of Income division of the IRS Research, Analysis and Statistics Unit, which included detailed information on equipment and structures investment for a broad class of industries and many small, private firms and all of the largest U.S. companies, but excluding firms potentially affected by Section 179. In doing so, they made three findings. First, they determined that the bonus depreciation allowance "has a substantial effect on investment, much larger than past estimates and much stronger than the conventional wisdom predicts," raising investment by an average of 17.3% between 2001 and 2004 and 29.5% between 2008 and 2010. They found also that the smallest firms in their sample

142 Zwick at 2-3.
143 Id. at 4, 10-11. According to the authors, they removed companies from the dataset that could have used Section 179 expensing to provide a purer analysis of the benefit of the bonus depreciation allowance. The authors considered the impact of Section 179 separately from bonus depreciation. See Zwick at 23-25, 31-32.
144 Id. at 2-3, 23, 27, 37. The authors stated:

These investment responses directly correspond to take-up of depreciation incentives--bonus take-up rates rise with the policy's generosity and many firms sharply bunch around the Section 179 kink point--in contrast to recent work on partial salience of sales taxes and the nonresponse of investment to dividend tax changes. Net investment responds to bonus depreciation as well, even though the reported balance sheet items do not affect taxable income. Debt issuance increases because of bonus depreciation and
demonstrated the largest response to bonus depreciation. Second, they determined that financial constraints on businesses amplify the effects of the bonus depreciation allowance, particularly for small and medium-sized businesses, non-dividend paying companies, and companies with low cash holdings. Third, they found that companies "only respond to investment incentives when the policy immediately generates cash flows." They determined that financially strapped companies act as if $1 next year is only worth 38 cents this year -- a discount rate of 97% -- which is caused by the financial frictions to which these firms are subject. In conclusion, they found that the bonus depreciation allowance has a strong tax policy effect on economic behavior.

VI. Conclusion

There is conflicting evidence of the benefit to the economy of the bonus depreciation allowance and Section 179 expensing. In addition, if the intention of Section 179 expensing and the bonus depreciation allowance is to create an incentive to businesses to invest in qualified property, the delay in enacting these depreciation allowances in recent years, particularly in 2010, 2012 (for Section 179 limits), 2014, and potentially 2015, and the piecemeal way they are extended, limits their effectiveness.

Based on the current legislation pending in Congress, the President's 2015 budget request, cost data from the Joint Committee on Taxation, and the analyses conducted by Guenther and Gravelle, Section 179 expensing is far less controversial and costly than the

---

payroll and dividend payments—which are double reported—respond as well. Thus the observed response is a policy response that does not reflect a mere reporting response, but rather reflects real economic behavior.

Id. at 27 (citations in text omitted).
145 Id. at 28.
146 Id. at 4.
147 Id. at 4 (emphasis in original).
148 Id. at 5.
149 Id. at 5.
bonus depreciation allowance. However, the Zwick and Mahon study demonstrates that for businesses that are under financial stress, both depreciation deductions are seen as desirable and result in a sizeable increase in investment. It is not yet clear whether Congress will decide to re-enact either the Section 179 limits and the bonus depreciation allowance in 2015 and beyond.