LESSONS IN FISCAL ACTIVISM

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ABSTRACT

This article highlights an anomaly. It shows that two tax rules aimed to achieve a similar goal were introduced at the same time. Both meant to be temporary and bring economic stimuli but received a dramatically different treatment. The economically inferior rule survived while its superior counterpart did not. The article reviews the reasons for this paradox. It shows that the causes are both political and an agency problem. The article not only enriches an important and ongoing debate that has received much attention in recent years, but also provides important lessons to policymakers.

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INTRODUCTION
One thing about businessmen— they condition more readily than any maze-
running rats or the most impressionable of Pavlov’s dogs. Give them a
reward for increasing their investment in new plant and equipment -- the 7
percent investment credit – and watch them run for it. Threaten to take it
away, and watch them run even faster.
—Albert L. Kraus, N.Y. Times, 1969

In the last half century, we have witnessed a massive expansion of of
government-provided incentives. The use of tax preferences produces
many advantages that increase the rate of return on cash flow from
investments. More recently, during reform debates Representative Kevin
Brady (R-TX) declared that extending tax incentives for investments
would stimulate the economy and help close the “Growth Gap” between
current and previous economic recoveries.

“The bottom line” he avowed, “is that faster growth in business investment generates faster
private-sector job growth.” On the other hand, economic policy
specialists continue to assert that the merits of tax benefits for capital
investment or job creation are dubious.

1 Albert L. Kraus, Investment credit—Possible Suspension Sparks Advance in
2 It allows taxpayers to recover their cost faster, lower the effective tax rate, and
reduce the net cost of new investments.
3 JOINT COMMITTEE ON ECONOMIC, LOSING THE GROWTH GAP, REPUBLICAN STAFF
4 Id. See, also Andrew Lundeen, Permanently Extending Bonus Depreciation
Grows the Economy, TAX FOUNDATION BLOG (May 27, 2014),
http://taxfoundation.org/blog/permanently-extending-bonus-depreciation-grows-
economy; William McBride, The Economic and Budgetary Effects of bonus Expensing,
Fiscal Fact No. 428, TAX FOUNDATION PUB. (April 29, 2014),
MOLLY F. SHERLOCK, CONG. RESEARCH SERV., R43898, TAX PROVISIONS THAT EXPIRED
Ashlea Ebeling, Depreciation Tax Extenders Big Bonus For Business Owners, FORBES,
Dec. 18, 2014; John D. McKinnon, House Committee Approves Permanent Depreciation
Tax Break; Proposal Allowing Businesses to Deduct 50% of Capital Purchases Up Front
Heads to Full Senate, WALL ST. J., May 29, 2014; Bill Smith, Small Business Advice:
Hurry, these Four Tax Breaks Expire at the End of the Year, WASH. POST, Jan. 3, 2014.
5 See JANE G. GRAVELLE, CONG. RESEARCH SERV., R43432, BONUS DEPRECIATION:
ECONOMIC AND BUDGETARY ISSUES, (2014), available at
http://nationalaglawcenter.org/wp-content/uploads/assets/crs/R43432.pdf; GUENTHER,
infra note 11 (holding that tax incentives such as the bonus depreciation “did not appear
to be very effective in providing short-term economic stimulus compared with
alternatives.”). Critics argue that investment incentives such as the bonus deprecation are
tax breaks that help big companies. See Thomas Gryta, AT&T, Verizon Tax Breaks Fail
to Produce Jobs, Lower Bills Didn’t Lead to Increased Investment or Employment, WALL
ST. J., Dec. 11, 2014 (“AT&T and Verizon appear to be using the benefit as intended, and
both are plowing tens of billions of dollars into their networks…Meanwhile, the
companies have kept their capital spending relatively flat since the stimulus was adopted,
and their employee count has dropped by more than 100,000 people, a fifth of their
combined work forces.”). See also, Chuck Marr and Brandon DeBot, House “Extenders”
Bills Represent First Wave of Effort to Enact Costly, Permanent Tax Cuts, CBPP, Feb.
10, 2015, http://www.cbpp.org/files/5-7-14tax.pdf (noting that adding bonus depreciation
to the extenders provisions would raise the cost over 2016-2025 to roughly $700 billion,
The immediate expensing rule is an example of a capital investment incentive. Enacted as a temporary measure in the late 1950s, Congress has perpetually extended it to the present day. In fact, in his 2015 revenue proposal, President Obama suggested increasing and making this tax preference permanent. Under this rule, taxpayers benefit from deducting the cost of new purchases of capital assets instead of capitalizing it over their ordinary useful life. The benefit phases out, dollar for dollar, when a taxpayer’s cost surpasses a certain threshold.

The immediate expensing rule is a tax preference that reflects a historical path dependency. It is one of numerous tax benefits enacted in 1958 as part of far-reaching auspicious small business legislation in hope of creating jobs and boosting economic growth. However, a closer look at the immediate expensing rule reveals that its cover does not correspond to its content. De facto, the provision’s language does not confine the benefit to small firms. Nevertheless, this measure has been termed, considered, and promoted a small business tax benefit for political reasons. In fact, although immediate expensing’s label has remained unchanged, in recent years its declared policy removed the focus on small business, and generally declared its aim of stimulating investments for businesses of all sizes. The “small business” affiliation historically, then, remained in the section’s title for its rhetoric value.

A distant cousin of the immediate expensing rule, the late Investment Tax Credit (“Investment Credit”), underwent a different narrative. The investment credit was enacted in 1962, suspended in 1966, restored in 2001, and finally amended in 2004 to permanently extend it for businesses of all sizes.

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8 Id.

9 See Mirit Eyal-Cohen, Why is Small Business the Chief Business of Congress? 43 Rutgers L. J. 1 (2012) (arguing that the favoritism of small businesses is entrenched in the American society due to notions of liberty).

10 See generally, Mirit Eyal-Cohen, When American Small Business Hit the Jackpot: Taxes, Politics, and The History of Organizational Choice in the 1950s, 6 PITTS. TAX REV. 1, 6 (2008) (describing the conditions that led to the enactment of small business favoritism in the 1950s).

1967, repealed in 1969, reinstated in 1971, increased in 1975, and rescinded in the tax reform of 1986.\textsuperscript{12} The investment credit never reappeared again albeit numerous proposals put forth over the years to reintroduce it. Under conventional wisdom, credits are economically superior to deductions because they provide dollar-per-dollar reduction in tax liability. The effect of expensing is more modest. It simply allows faster-than-normal depreciation deduction.\textsuperscript{13} Yet, contrary to general belief and although both measures were enacted as temporary stimulus measures during the same period, expensing survived while the investment credit did not.\textsuperscript{14}

This article starts by asking: What is the reason for these different legislative accounts? Particularly, why did the economically inferior rule survive while its superior counterpart did not? The article then offers two obvious answers for this paradox. First, a tax credit is considered a costly direct subsidy that forgoes a portion of taxable income, whereas immediate expensing is portrayed as a timing rule that provides taxpayers with the benefit of time value of money through accelerated depreciation. Second, the immediate expensing rule enjoyed bipartisan support throughout history because Congress promoted it (unduly) as a small business preference. The investment credit was considered a tax break granted to already profitable businesses that helped lower their tax bill. In this David and Goliath matchup, the immediate expensing persisted while the investment credit was knocked down.

However, this metaphor is not sufficient to explain the oddity of the two tax rules’ history. Likewise, politics and revenue loss are too simplistic as explanations for the endurance of the immediate expensing rule and the demise of the investment credit. This Article identifies an agency problem as another explanation for the anomaly. It focuses on changes in tax policy and the emergence of fiscal activism in the 1960s. It points out to New Economics theory that put a growing focus on economic stimulus to elucidate the differing historical accounts of both tax rules.

The failure of the investment credit was greatly attributed to a built up of public dislike of fiscal over-activism. New Economics theory emerged in the 1960s and prescribed increased monetary, economic, and fiscal actions. It shifted the focus from a passive tax policy to a more active fiscal agenda. With the support of the Council of Economic Advisers, the government started utilizing the tax system as an impetus of “functional economic calibration.”\textsuperscript{15}

The investment credit was inflicted with an agency problem. It was viewed as a failed experiment in New Economics theory an unwanted

\textsuperscript{12} See Figure IV in the Appendix.
\textsuperscript{13} See Figures II-III in the Appendix.
\textsuperscript{14} See Infra Part III.
government intervention in market forces. Eventually, the demise of faith in government fiscal activism to stimulate the economy led Congress to abandon the investment credit. Yet, curiously, the immediate expensing rule has continued into the present notwithstanding a lack of clear evidence regarding its efficiency in stimulating new market demand.\textsuperscript{16}

Once introduced, investment incentives tend to become entrenched in our tax system and are politically hard to retract.\textsuperscript{17} The debates during the recent “fiscal cliff” demonstrated this truism.\textsuperscript{18} Such maxim is particularly prominent in current tax reform proposals put forth by President Obama and Chairman Camp to permanently extend investment incentives such as the immediate expensing rule and the bonus depreciation.\textsuperscript{19} These proposals continue to ignite present debates in the media.\textsuperscript{20} Investment incentives are some of the largest tax expenditures

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\textsuperscript{16} See supra notes 5, 11.

\textsuperscript{18} See, e.g., Richard Q. Lewis III, Are Tax Expenditures Reaching Their Goals? A View From the Fiscal Cliff, 87 APR FLA. BAR J. 28 (2013) (“Using the tax code as a policy tool, the government has sought, among other aspirations, to increase home ownership and college enrollment among low- and middle-class taxpayers.”). See also J. D. Harrison, How the ‘Fiscal Cliff’ Deal Affects Entrepreneurs and Small Businesses, WASH. POST, Jan. 4, 2013 (reporting Congress’s attempts to appease small business by providing extension of immediate expensing and the bonus depreciation in order to provide a boost for small employers planning to invest back into their firms in 2013); De A. Conrad, For Small Businesses, Tax Law has Become a Moving Target, N.Y. TIMES, Feb. 10 2013; Don Lee, and Jim Puzzanghera, The Economy: Cliff Deal Lifts Stocks and Doubts; Spending and Hiring Are Expected to Suffer Over Uncertainties About The U.S. Debt, L.A. TIMES, Jan. 3, 2013.


\textsuperscript{20} See e.g., John D. McKinnon, House Committee Approves Permanent Depreciation Tax Break: Proposal Allowing Businesses to Deduct 50% of Capital Purchases Up Front Heads to Full Senate, WALL ST. J., May 29, 2014; Bill Smith, Small Business Advice: Hurry, these Four Tax Breaks Expire at the End of the Year, WASH. POST, Jan. 3, 2014;
}
in the U.S. Budget. The ability to write off investments is a valuable benefit for taxpayers — and costly to society. Scholars questioned whether the tax system should provide such incentives and whether it should continue to extend them when there is little indication of their success in stimulating growth. These discussions also considered the optimal form of such incentives. Whether we should use credits or


22 U.S.C. §168(k). See, e.g., Michael J. Graetz and Rachael Doud, Technological Innovation, international Competition, and The Challenges of International Income Taxation, 113 COLUM. L. REV. 347 (2013) (using the bonus depreciation to point out that nations choose to subsidize technological innovation because, in the absence of such subsidies, crucial research and development would be underproduced); Tom C.W. Lin, The New Financial Industry, 65 ALA. L. REV. 567 (2013) (claiming that an incentive-based approach would be to encourage industry participants to enhance their cyber defense by allowing participants to use bonus depreciation); But see Anthony C. Infanti, Tax Reform Discourse, 32 VA. TAX REV. 205 (2012) (noting tax incentives encourage investment in capital at the expense of investment in labor); Calvin H. Johnson, Taxing GE and Other Masters of the Universe, 132 TAX NOTES 175, 183-84 (2011) (pointing to the negative impact and the bias of investment incentives on the effective corporate tax rate); Theodore P. Seto, The Problem with Bonus Depreciation, 126 TAX NOTES 782, 782-83 (2010) (arguing investment tax incentives have the effect of creating “jobless recoveries” by shifting businesses toward greater use of capital and less use of labor).

deductions for stimulus purposes is an important decision in designing tax measures. The article pertains to shed new light on these discussions. It identifies factors that not only enrich the debate on the use of the tax system to influence taxpayer’s behavior, but also provide guidance to policymakers.

The Article proceeds as follows. Part I discusses the depiction of the immediate expensing rule in legislative history as a small business measure and the emergence of the investment credit. Part II describes the political settings and unfolds the shift in tax policy toward fiscal activism under the New Economics theory. Part III describes the experimentation with fiscal activism and the agency problem of the investment credit. Part IV concludes by providing some insights regarding the two narratives alongside the current debate over investment tax incentives.

I. THE POLITICS OF SMALL BUSINESS INVESTMENT INCENTIVES

Immediate expensing is an extreme form of depreciation. It works to recover the cost of the acquired property over faster than usual recovery periods, thereby providing taxpayers with the advantage of time value of money. For example, during years 2010-2013, taxpayers were permitted immediate expensing of up to $500,000 of qualified property that cost up to $2 million. Accordingly, they could expense their cost of capital investments until those total expenditures reached $2,500,000.

This part tracks down the historical roots of the immediate expensing rule and the investment credit. It focuses on the role that small businesses played in the enactment and persistence of the immediate expensing rule, compared to other capital investment incentives that did not benefit from such affiliation. Specifically, it points out to political rhetoric used to portray expensing as a temporary and simple small business tax preference. Expensing meant to help small business retain internal earnings for equipment replacement and expansion, while the investment credit was viewed as a big business subsidy.

A. Recessions and the Obsolescence Gap

The concept of faster-than-normal depreciation, or rapid amortization, appeared during times of crises, primarily during World
Wars I and II. Faster-than-normal “write-off certificates” were offered as a way of preventing losses for companies that installed plants exclusively for wartime use. At that time, it became apparent that there was a major gap between the capital recovery rules set by the Code and the actual wear and tear of the property, especially in the first year the property was placed in service, also known as the “obsolescence gap.”

Many foreign nations addressed the first-year obsolescence problem by providing additional initial allowances of 20%–50%. Yet, under the U.S. Code, there remained a need to provide evidence of additional technological obsolescence to deviate from normal depreciation schedules. This was a major hurdle and a principal deficiency of the old depreciation system.

Technological obsolescence was a direct consequence and a major part of postwar industrial inefficiencies. With the advance of industrial developments and the scientific technical revolution during the 1940s, there was a growing necessity to update and replace old machinery. Studies indicated that the modernization of U.S. industry was much needed at that time; the American industry was in the process of producing modern weapons of the atomic and space age with ineffective and obsolete tools. However, even when new equipment was purchased, a rapid wear and tear usually occurred in the first year of its life.

In the years that followed World War II the U.S. economy saw a capital investment boom. Plant and equipment expenditures were at the height of their rates. However, overproduction by large industrial firms...
and a series of natural disasters resulted in the American economy entering a deep recession period. In 1957, industrial production severely plummeted, prices on the New York Stock Exchange dropped, and consumer prices rose to record levels. In 1958, the number of business failures reached 1,100 a month, the highest rate since 1940, and unemployment reached 7.5%. Small and new businesses accounted for the majority of the business failures at that time. Small business witnesses appeared before congressional committees and presented a gloomy picture of their affairs, attesting that they had had to borrow funds in order to pay taxes, purchase equipment, and continue operations.

Financing the replacement of machinery and equipment turned out to be a challenging task, especially for small businesses that relied on their internal earnings. Professionals, scholars, and businesspersons urged the Treasury to provide faster depreciation schedules; they saw the solution to the obsolescence gap as permitting the recovery of the investment in a shorter time. The Department of Commerce identified two main reasons for the post-World War II equipment replacement problem: the rise of inflation and the rapid rate of obsolescence with the advance of technology. Consequently, it acted to revise depreciation policy and to provide investment incentives to maintain the U.S.’ competitive position at the same level as that of the rest of the world.


39 Richard Sutch, Business Incorporations and Failures—Numbers and Liabilities: 1857-1998 Table Ch408-413, in HISTORICAL STATISTICS OF THE UNITED STATES, EARLIEST TIMES TO THE PRESENT: MILLENNIAL EDITION Ch408-413 (Susan B. Carter et al. eds., 2006).


41 Keeping the Records Straight, TIME, Aug. 20, 1956, at 82. See also, Needed: Talent, Training & Tax Cuts, TIME, Nov. 12, 1956, at 98 (“the newest figures on small business are cause for some alarm”).


45 See Table of Historical Inflation Rates by Month and Year (1914-2013), available at: http://www.usinflationcalculator.com/inflation/historical-inflation-rates/

The recession years of the late 1950s, and the financial predicaments of that time, found Congress in a “mood” to help and encourage small business, and augmented its sense of responsibility to their well-being. The introduction of massive small business tax preferences in 1958 was a major part of Congress’s plan for national economic recovery. At that time, Congress viewed small business as an important element in stimulating economic activity and creating jobs, therefore, helping small businesses was viewed as assisting the recovery of the economy. The next section depicts the creation of the expensing rule as a route Congress took to address some of these issues.

B. The Birth of the Immediate Expensing Rule

The abundance of small business favoritism is a result of politics. The exalted status that small business as a bedrock of America protected the expiration of temporary small business preferences such as the immediate expensing. Pursuant to public choice theory, over the years politicians have been beholden to the interests of their constituents, many of whom own, operate, or work for a small business; and, indeed, there is some historical evidence to this effect. No politician wanted to be seen attacking “Main Streets across America” and taking money away from small businesses that are regarded popularly as “the engine of job creation in this country.”

47 Eyal-Cohen, supra note 10.
48 For example, the government approved many expansions of the SBA loan program during the 1960s to address the tight credit problem of small firms. See, Small Business Agency Loan Ceiling Increase is Approved by House, WALL ST. J., July 3, 1962, at 3; House Unit Votes to Raise SBA’s Ceiling on Loans, WALL ST. J., Jan. 8, 1962, at 26; Small Business Agency Loan Ceiling Raised $250 Million by Senate, WALL ST. J., June 15, 1962, at 14; Small Business Agency Curbs Loans to Firms: Citizes Disaster Lending, WALL ST. J., Nov. 10, 1964, at 3.
52 Phillips Shavceoff, S.B.A. Under Fire: Program To Assist Minorities Discounted N.Y. TIMES, May 16, 1971, at F3; A Bright Forecast for Small Businesses, N.Y. TIMES, June 24, 1984, at L120 (avowing to the notion that the business of our country is small business).
53 See, e.g., Eyal-Cohen, supra note 10, at 16 (demonstrating how lobbying efforts and rhetoric were some of the factors that influenced the creation of the Small Business Corporation in 1958); Eyal-Cohen, supra note 9, at 5 (demonstrating through the Small Business Investment Company the power of small business institutions such as small business congressional committees and the Small Business Administration).
54 Senate Democrats Fight to Include Credit Relief for Small Businesses, Congressional Documents and Publications, July 22, 2010 (Patty Murray (D-WA)).
55 Id. (Amy Klobuchar (D-MN), But see IACI Eye On Boise, July 19, 2010 (“In reality, the real cynical political motivation for touting ‘small business’ is to create an ‘us
Small business culture developed from our nation's philosophy of separation of powers, one of the bases of our democracy. Throughout history, suspicions about the concentration of power brought the government to favor small firms, viewing them as guardians of fair competition and free society. Natural disasters and economic shocks reinforced preconceived notions that small businesses had to be salvaged whenever events out of the government's control harmed their well-being. This tendency brought government to expand its patronage over the years by providing small firms with special preferences through the legal system.56

The birth of the immediate expensing rule in 1958 is an example of this truism. This rule was designed as part of comprehensive and far-reaching tax incentives to encourage and foster small business.57 The new immediate expensing titled “Additional First-Year Depreciation Allowance for Small Business” permitted businesses, individuals, or corporations that purchased depreciated property with a useful life of at least 6 years to deduct up to a maximum of then $2,000 during the first year when such property was placed in service.58 Congress hoped this mechanism would encourage additional investment in small business, since it provided for a faster recovery of capital before taxing earnings.59

During committee-hearings on the topic of depreciation policies, representatives from the machine-tool industry, an apparent interest group that benefits from any equipment purchase incentives, argued that depreciation rates did not provide adequate allowances essential for investments in new machinery by small businesses at that time.60 These representatives supported small businesses by expressing concerns regarding their ability to maintain modern equipment and compete with larger firms.61 They emphasized the crucial need to reduce the investment risk in small businesses, and to improve their credit condition as a way of stimulating economic growth.62 One of their proposals was to permit taxpayers greater flexibility in determining the length of the
depreciation period, and allow more rapid tax-free recovery on investments.\footnote{Id. at 672.}

Soon after its enactment, it became clear that immediate expensing was not utilized only by small businesses.\footnote{Id. See Figures I and II in the Appendix. In fact, dollar-wise immediate expensing benefited entities with higher effective tax rates. H. Comm. on Ways and Means, 85th Cong., Tax Revision Compendium, Compendium of Papers on Broadening the Tax Base, Vol. 1, 47-48 (Comm. Print 1958).} Nevertheless, there was a political unified front that supported this measure across parties, businessmen, professionals, and the media. The political value of the “small business stock” was on the rise. Any proposal that contained the proverbial “small business” received wide bipartisan support.\footnote{See Eyal-Cohen, supra note 10.} Big business organizations concurrently began to push for the expansion of immediate expensing by eliminating the limitation on the maximum amount of the allowed immediate deduction.\footnote{J. Keith Butters & John Lintner, Effects of Federal Taxes on Growing Enterprises 2–4 (1945).} Clearly, foreign competition was not the primary concern of small business at that time; rather, they were worried about tight credit problems and national competitive hurdles.\footnote{See, e.g. Chamber of Commerce advocating such expansion, Revising Tax on Gains from Sales of Depreciable Personal Property, Hearings Before H. Comm. on Ways and Means, 86th Cong. 147 (1960) (statement of Frank T. Powers Jr., President, Powers Chemco, Inc.).} Nonetheless, the Chambers of Commerce pushed for the expansion of the small business immediate expensing rule in the name of foreign competition.\footnote{Id.} The American Machine Tool Distributors Association, whose constituents were poised to gain greatly from any type of the equipment investment incentives, also advocated for the increase in the scope of immediate expensing.\footnote{1961 House Hearings, supra note 32.} They, too, called for a complete removal of the maximum limitation on the cost of the property allowed to be expensed and an increase in the amount to be expensed to assist small businesses.\footnote{For example, they called for elimination of the $10,000 maximum cost and the 6-year useful-life limitations, and raising of the 20\% initial allowance rate to at least 30\%. See Id. (“Removal of this limitation would provide the stimulus that is sought through the investment credit but without the subsidy involved in the latter.”).} Small business lobby also advocated for immediate expensing and the expansion of its scope. Small business owners praised the new legislation and pleaded with the government to continue to provide them with faster depreciation rules that left them with more internal investment funds to purchase needed equipment and machinery.\footnote{Id. (“By reason of the adoption of immediate expensing, my company and certain of its subsidiaries have already been enabled to acquire badly needed machine tools and other Immediate expensing qualified property by tapping investment funds otherwise not available to them...”).}

Conversely, some small business owners testified that, due to its dollar limitation, immediate expensing had a restricted effect on encouraging
their expansion. Instead, they advocated for a full write-off of all the costs of the asset during the first year the asset was placed in service.

During committee hearings, professionals and businessmen stressed the financing cycle of small business, by which the retention of earnings was crucial for the purposes of reinvestment and expansion. Because depreciation deductions were spread over the useful life of the property, it required additional cash for expansion and made growth more dependent on the business’s borrowing power than on its earnings. Small businesses, they emphasized, had an inferior position in borrowing due to their inherent risk, which left them primarily dependent on internal funding and retained earnings for any type of expansion. Arguably, the tax benefits simply “leveled the playing field” to account for the higher cost of capital to fund small businesses.

Scholars were of the few skeptics that doubted the effectiveness of the new expensing rule. They argued that while it may result in some allocation of funds for small businesses growth, it was more likely to postpone the timing of tax reckoning and to serve the machinery and equipment production industry. Thus, if the tax benefit simply accelerated the timing of purchases, rather than increasing the net amount of purchases, it would not have much of an overall long-term stimulative effect. If property was to be purchased every year, it would result in an overall permanent postponement of tax on qualified property. The next section describes the concurrent chain of events that eventually led to the enactment the investment credit.

C. Enactment of The Investment Tax Credit

As part of proposals in 1961 to stimulate for economic growth and improve the competitive position of the nation’s industry, President Kennedy and Secretary Dillon proposed a new investment credit. On October 16, 1962, the government passed the Revenue Act of 1962, which added section 38 to the Code, providing a new credit of 7% of the property’s cost with at least 4 years of useful life. In the same year, the Treasury also modified the treatment of depreciation, liberalizing

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73 Id (statement of Al. J. Braxton, Certified Pub. Accountant, Arthur Andersen & Co.).
74 Id.
76 Id.
78 See 26 U.S.C. §46(c) (2) (1962). The credit was limited to 100% of the tax liability up to $25,000, plus 25% of any tax liability in excess of $25,000. 26 U.S.C. §§46, 48 (1954).
depreciable asset lives and the overall approach to the determination of the depreciation deduction.79

However, while retaining the view that the primary function of depreciation is to measure net income over time, the Administration had greater plans in mind for the investment credit. By creating incentives for capital purchases that would not have otherwise occurred the 1962 act intended to stimulate growth and create new jobs.80 Senator Kerr (D-OK), who led the floor debates in the Senate for the administration’s tax program, characterized the investment credit as the single most important measure to strengthen and revitalize the U.S. economy enacted by the 87th Congress.81 Harvey E. Brazer, Director of the Office of Tax Analysis at the Treasury Department, noted that the administration’s goal was to provide a more realistic revision of the depreciation rules and to equalize U.S. business with its foreign competitors in terms of the tax treatment of capital assets.82

Several interest groups supported the enactment of the new tax credit. The American Machine Tool Distributors Association evidently gained from any kind of equipment purchase incentive, more so when their customers were established businesses with stable positive tax liability to offset against the investment credit. Their representative appeared before the Ways and Means Committee, emphasizing the connection between national defense and the need for an efficient and effective national production base.83 When supporting the enactment of the investment credit, the representative argued that the revenue loss from the tax credit could be offset by the saving in cost production resulting from the new machinery and equipment.84

Another lobbying group that was set to benefit from the enactment of any type of investment incentive was the National Machine Tool Builders Association. However, this association believed that the proposed credit was too complex and very limited in its application, due to its many restrictions.85 Instead, the association urged the committee to expand immediate expensing by eliminating the rule’s limitations and allowance rate. Immediate expensing was described as a more effective and equitable measure, compared to investment credit.86 Conversely, the

82 Harvey E. Brazer, supra note 80, at 7.
83 1961 House Hearings, supra note 32.
84 Id.
85 Id.
86 Id. (“Unlike the proposed credit, an initial allowance provision can be both simple and equitable in its application. A first step of this kind was adopted in this country in 1958 with the enactment of a limited first year depreciation allowance as immediate expensing of the Internal Revenue Code.”).
next part illustrates that the investment credit had a greater economic potential to lower effective tax rates than the immediate expensing rule.

D. The Economic Effect of Credit vs. Deduction

The merits of investment tax incentives have been greatly debated. Economist E. Cary Brown demonstrated that if we allow taxpayers to accelerate the recovery of their capital investments, their effective tax rates on income from those investments will be zero if they have sufficient income from other sources to absorb the deduction. The Cary Brown theorem demonstrates that the theoretical equivalence of these incentives, under certain assumptions, is exempting investments from tax altogether. Professor Seto further argued that expensing has the effect of making the government a partner in taxpayers’ investment at the percentage of tax rate of taxpayers’ investment.

Both immediate expensing and the investment credit are capital investment incentives that provide up-front additional cash flow to help finance the equipment purchase. If financed with debt, Professor Alan Auerbach argued, they can even produce negative taxes, as the taxpayer receives a tax benefit without bearing any risk. The negative tax acts like cash payments or subsidies for projects, regardless of their economic merit. In fact, the taxpayer receives a double tax saving from being able to both deduct the interest on the debt used to purchase the equipment, and the tax savings from being able to immediately deduct the cost of the asset against positive income.

Professor Calvin Johnson argued against the use of capital investment tax incentives claiming that they change the balance between supply of, and demand for investment projects. Policy specialists at the Congressional Research Service echoed this notion, stating that immediate expensing has the potential to restrain economic growth. It thus so by encouraging a greater flow of capital into investments that may produce lower returns than investments not favored by these incentives. Professor Ted Seto added that investment tax incentives are

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87 Seto, supra note 26.
89 Seto, supra note 26. Similarly, Professor Johnson argued that investment incentives allow for the cost of the capital investment to go untaxed. This ability to make or continue investments with pretax “soft money” is an extraordinary privilege. Calvin H. Johnson, Soft Money Investing under the Income Tax, 1989 U. Ill. L. Rev. 1019, 1020 (1989).
90 Alan J. Auerbach, The New Economics of Accelerated Depreciation, 23 B.C. L. Rev. 1327, 1346-48 (1982) (demonstrating in tables 5 & 6 that the present value of accelerated cost recovery system deductions, plus the investment credit on a $1 investment, was greater than $1, producing a negative effective tax rate.).
91 For example, if a taxpayer borrows funds to purchase machinery, both the interest on the loan and the immediate expensing is currently deductible, creating “double dipping” of tax benefits. See Linda Sugin, Encouraging Corporate Charity, 26 Va. Tax Rev. 125.156 (2006).
93 Gary Guenther, Cong. Research Serv., RL31852, Small Business
not only tax subsidies for certain capital investments, but are also tax penalties on labor, and are partially responsible for high borrowing and “jobless economic recoveries” during the 2001-2004 and 2008-2011 recession years.94

Nonetheless, the upshot of using the immediate expensing or the investment credit on tax liability differs because credits and deductions have diverse economic effects. Arguably, taxpayers prefer credits to deductions because they provide greater and faster tax benefits. The value to the taxpayer of the right to recover the cost of an asset depends upon the time and manner of the recovery, the tax rate, and the appropriate interest or discount factor if the recovery is postponed. Both the immediate expensing rule and the investment credit work to accelerate the recovery of that expenditure over a shorter period of time, or via a one-time tax credit. A depreciation deduction is a charge against income. It pertains to spread the cost of acquiring an asset that generates income beyond the taxable year in which the purchase is made.95 A credit provides a dollar-for-dollar reduction from tax due. Figure II in the Appendix demonstrates the difference between the operation of the tax credit, as opposed to the immediate deduction. The investment credit was more valuable for business taxpayers with positive tax liability, than those with losses or no tax liability.

The immediate expensing was viewed merely as a timing rule.96 Furthermore, as enacted, the benefit of immediate expensing was minor and very limited in its scope, because of the initial restriction placed on the maximum allowed deduction.97 As opposed to the common rationale, the primary reason for setting this limit was not to target small businesses; rather, it was for budgetary reasons, in view of anticipated defense expenditures during the Cold War.98 The predicted loss from the investment credit was $1.3 billion every year, and this was deemed a permanent loss, because it did not reduce the cost basis of the property.99


95 See Brazer, supra note 80. See also, Seto, supra note 26 at 235 (In his casebook, Professor Seto provides nice illustrations of the effect of investment tax incentives on after-tax cash flow and effective rate of return.).

96 Hearings on the Revenue Act of 1962, supra note 77, at 3088-89 (statement of Dan Throop Smith, Professor of Finance, Harvard Graduate School of Business Administration).

97 The investment credit was limited to the taxpayer’s tax liability and could be carried over to following years. The historical amounts and maximum limits of the immediate expensing rule are provided in Figure I of the Appendix.


99 Initially, the investment tax credit provisions as enacted in 1962 required reduction of the depreciable tax base of any qualified property in an amount equal to the credit. See Revenue Act of 1962, Pub. L. No. 87-834, § 2(b), 76 Stat. 960, 970 (repealed 1964). Adoption of this requirement in an amendment proposed by Senator Russell Long.
The value of the immediate deduction was equal to the deduction multiplied by the tax rate, whereas the value of the credit was equal to the full credit portion of the cost. Because the tax credit was not refundable and offset only positive tax liability, it was beneficial mostly to those businesses with positive tax liability that were already capable of purchasing new equipment and machinery. It was less beneficial to firms with scarce profits that were dependent on an existing stream of income and net after-tax earnings in order to make new purchases. In the case of such businesses without positive tax liability, immediate expensing was more beneficial than a credit, because it allowed for self-financing of expansion through deferred income taxes.

Accordingly, among those small businesses that were dependent on having profits in order to expand, and which often did not have positive taxable income, the investment credit was considered to be less favorable. The investment credit was beneficial, though, to many profitable corporations. The next part describes the emergence of the New Economic philosophy, during the 1960s, which was the driving force behind the investment credit and attributed to its agency problem.

II. NEW ECONOMICS IN THE SERVICE OF FISCAL ACTIVISM

The first 50 years of the modern tax system saw tax policy applied in a traditional manner, focusing on revenue-raising goals to assist in the country’s war efforts. Until the Great Depression of the 1930s, orthodox fiscal policy called for annual budget-balancing. During wartime, tax policy was utilized to provide revenues to support the war efforts. When conflicts were over, wartime taxes were scaled back, but still left at a high level. After World War II, this policy was replaced by the concept of the “stabilizing budget,” a policy that maintained a tax structure that would periodically be recalibrated to maintain a moderate surplus at high employment, with reliance on certain “built-in stabilizers” and monetary policy to combat ordinary recessions.

The post-World War II period saw a shift in tax policy. At the end of the 1950s, the American economy was hampered by recessions and shortage of working capital, compounded by high interest rates and reflected concern over the revenue cost of the credit. See S. REP. NO. 1881, 87th Cong., 2d Sess., reprinted in 1962 U.S. CODE CONG. & AD. NEWS 3304, 3321-22. In 1964, Congress repealed the basis adjustment feature thus significantly liberalizing the credit and greatly increasing its value. See, e.g., ‘64 Investment Credit Claim Was $1.3 Billion, WASH. POST, Aug 30, 1967 at A1 (“a total investment credit of $1.3 billion was claimed in 1964 by half of the 649,000 corporations reporting income tax, the Internal Revenue Service revealed today.”). See generally, Allaire Urban Karzon and Charles H. Coffin, Extension of the At-Risk Concept to the Investment Credit: A Shotgun Approach To the Tax Shelter Problem, 1982 DUKE L.J. 847, 852 (1982) (describing at-risk restrictions placed on taxpayers attempting to use the investment as a tax shelter device). J. Henry Wilkinson, Jr., The Investment Credit Under the Revenue Act of 1962, 42 TEx. L. Rev. 498, 498 (1964).

100 Figure III in the Appendix further illustrates this effect.

101 Surrey, Supra note 79.

102 Changes in the money supply were used moderately to influence interest rates and yields on corporate stock. TERBORGH, infra note 119 at 11-13.
spiral inflation. In 1959, Congress initiated a wide-ranging examination of the ways by which the income tax structure increased inequities and the narrowing of the tax base. These concerns developed into hearings held by the House Ways and Means Committee.

The Kennedy administration assumed office in January 1961, in the midst of a recession and sought ways to stimulate the economy. The government began to utilize the tax system to direct taxpayers’ behavior to achieve social goals. No longer was fiscal policy aimed at budgetary balancing, but a new era of furthering social and economic goals was underway. Paramount among tax measures was the Revenue Act of 1962, which added the investment credit and made important changes based on the New Economics Theory. The next sections focus on the role the investment credit played in the transformation of tax policy from revenue-raising to society’s window and economic stimulus. Eventually, this ambitious vocation turned out to be an agency problem and yet another nail in the investment credit’s coffin.

A. Compensatory Budget Policy

The economic decline of the early 1960s was still underway and was expected to go further. The administration’s response was almost entirely to focus on the spending side of the budget, using presidential orders to speed up federal disbursements, such as accelerating procurement placements, highway fund allocations, tax refunds etc. During 1962-1963, the situation escalated when the projected economic mark of 4% unemployed was not attained.

President Kennedy decided to take things to the next level with a new stimulus theory. Backed by the Council of Economic Advisors he proposed a new approach to put an end to the period of slow growth. The President's Economic Report emphasized the need for the

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104 Mirit Eyal-Cohen, supra note 10.

105 Surrey, supra note 79 at 480

106 In addition, the administration’s tax reform activity was not limited to revenue-raising and the elimination of tax preferences, but began to focus on other considerations, such as eliminating unfairness. See Susan B. Hansen, The Politics of Taxation: Revenue Without Representation 105 (1983) (the author asserted that this shift in tax policy was a result of the will of “elected officials to maintain sufficient control over revenue and fiscal policy so as to be able to manipulate the economy and government spending for their own electoral benefit.”); See also, Carolyn C. Jones, Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax during World War II, 37 Buff. L. Rev. 685 (1989) (holding that during the second world war the tax system underwent a shift in tax burden from a few top individuals to an overall revenue machine); John F. Witte, The Politics and The Development of the Federal Income Tax 154, 117-118 (1985); W. Elliot Brownlee, Tax Regimes, National Crisis, and State-Building, in Funding the Modern American State, 1941–1995, at 93 (W. Elliot Brownlee ed., 1996).

107 Id. at 16 (“Each year has found the Congress engaged in the consideration of major tax legislation, and revenue measures of wide scope and important policy import have resulted.”).

108 Terborgh, infra note 119 at 12.

development of tax policies that would supplement monetary policy in assuring investment surplus. The report mentioned that this was intended to be a step further in the art of fine-tuning.\textsuperscript{110} The administration acknowledged that a tax provision might be an efficient tool to achieve a particular objective in certain circumstances, such as expanded outlays on machinery and equipment, which, in turn, promotes economic development as a positive economic approach. For the first time, the government began to apply affirmative fiscal actions to achieve economic growth.\textsuperscript{111} The administration’s economic policy viewed it appropriate to respond to recurring cycles of recession and recovery with expenditure increases as the weapon to end downslides.\textsuperscript{112}

However, the basic idea of the New Economics philosophy utilized by the Kennedy administration was not new. The idea of controlling economic activity through manipulation of the federal budget position was developed in the 1930s by British economist J. M. Keynes.\textsuperscript{113} Unlike neoclassical economics that promoted the idea of free markets adjusted by an “invisible hand”, Keynesian economic theory called for government intervention in the market to moderate cycles of economic activity.\textsuperscript{114}

What the New Economics theory added was the belief in the scope of such control and the desire not just to balance but also to spur economic growth by increasing federal spending and reducing taxes, or to restrict economic activity by doing the opposite.\textsuperscript{115} The “New Economics” doctrine called for utilizing fiscal,\textsuperscript{116} monetary,\textsuperscript{117} and expenditure policies in a flexible manner.\textsuperscript{118} The objective of New Economics was to make appropriate changes on either or both sides of the federal budget using four primary characteristics: 1) federal activism, 2) growth orientation, 3) accurate forecasting, and 4) functional calibration.

New Economics called for an active and flexible fiscal policy with a budget position revised as often as necessary.\textsuperscript{119} The theory portrayed the

\textsuperscript{110} Tax Changes for Shortrun Stabilization, Hearings Before the Subcomm. on Fiscal Policy of the J. Econ. Comm., 89\textsuperscript{th} Cong., 64 (1964) (statement of Carl S. Shoup).
\textsuperscript{111} Surrey, Supra note 79.
\textsuperscript{112} Id.
\textsuperscript{113} JOHN CUNNINGHAM WOOD, JOHN MAYNARD KEYNES, CRITICAL ASSESSMENTS 101–120 (1994).
\textsuperscript{114} Id.
\textsuperscript{115} Id. See also ECONOMIC REPORT OF THE PRESIDENT, supra note 109, at 70 (“Federal expenditures and taxes affect total employment and production by influencing the total volume of spending for goods and services.”)
\textsuperscript{116} Increase in governmental expenditures can be useful to stimulate the economy and decreased to stop inflation. Id.
\textsuperscript{117} Monetary policy can be used in a counter-cyclical manner by allowing greater credit in a lagged economy and restricting borrowing during inflation. Id.
\textsuperscript{118} Under this doctrine, in order to stimulate an economy, taxes can be reduced so as to spur consumer spending. During inflation, an increase in taxes can have the effect of reducing spending. For a general overview of the “New Economics” doctrine, see HEARINGS ON THE PRESIDENT’S 1967 TAX PROPOSALS BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, supra note 15 (statement of Joseph A. Pechman).
\textsuperscript{119} GEORGE TERBORGH, THE NEW ECONOMICS 8 (1968). In this book, George
tax system as in need of occasional “functional calibration”, and assumed
the correct position is the one that is correct for the given conditions, and
cannot be standardized over time. As opposed to the other theories,
New Economic was centered on the ever-rising potential of the
economy. It focused on gap-closing and development, as well as
utilizing statistical measures for the application of growth-oriented
approach. For that purpose, the theory relied heavily on forecasting.
The annual budget began to incorporate an average forecasting lead of 12
months. The incorporation of statistics and scientific calculations into
predictions allowed economists of the Council of Economic Advisors to
feel confident and optimistic about their ability to foresee market
changes and react accordingly.

However, critics of the New Economics theory dismissed its
effectiveness as counteractive, or contracyclical, fiscal theory. They
believed the theory had several fundamental problems. First, economic
forecasts were said to be speculative, inaccurate, and lengthy. There
were three time lags involved in taking tax action: the time it takes to
interpret statistical and economic data and officially recognize and
acknowledge the need for action (recognition lag), which can further lag
for political reasons; the time required to obtain Congress’s approval

Terborgh, an economist at the Machinery and Allied Products Institute and Council for
Technological Advancement, describes the essence of the New Economics theory from a
critical point of view.

Id. at 23.

120 Walter W. Heller, Adjusting the ‘New Economics’ to High-Pressure Prosperity,
in Managing a Full Employment Economy, Comm. for Econ. Dev. Symposium on

121 For example, since New Economics set as its goal the maintenance of economic
activity at the “full employment” level, it compiled a series of estimates of potential gross
national product (GNP) that would be created at a 4% unemployment rate from which it
subtracted the actual GNP to derive the “GNP gap”. It then utilized fiscal policy to
eliminate that gap. Id. at 20.

122 Id. at 105 (“What we are concerned with, however, is
the timing aspects of this form of fiscal action. If it is accomplished, it is subject to all of
the lags and affecting tax action- the recognition lag, the legislative lag, and the response
lag.”).

123 Id. at 97 (arguing that the average forecasting lead time is 12 months, far beyond
the effective range of the CEA and even if the budget were enacted as substantially as
proposed, this long lead time would itself preclude any semblance of precise fiscal
action.)

124 Id. For example, the Administration will be reluctant to admit to a recession until
forced by a period of consistent data.
after such recognition (legislative lag);\textsuperscript{128} and once a tax measure is enacted, there is a further lag in response of the economy to that action.\textsuperscript{129} According to the Treasury, these time lags took to 9-12 months.\textsuperscript{130} The Department of Commerce and National Industrial Conference Board estimated an even longer lag.\textsuperscript{131} Treasury Assistant Stanley Surrey was more pessimistic, professing that it takes two to four quarters for any significant impact to take place,\textsuperscript{132} while leading economist Joseph Peachman anticipated a 6-12 months lag before changes in consumer spending are witnessed.\textsuperscript{133}

Finally, critics contended that once a desired fiscal action is chosen, determining the magnitude of such action was purely speculative.\textsuperscript{134} It entailed assessing what would be the course of the economy in the absence of fiscal action, by how much should the action attempt to deflect it from its course, and what dosage is needed to accomplish the change. Rather than being self-evident, the determination of dosage was said to be cloudy and uncertain.\textsuperscript{135} Yet, despite its critics, New Economics enjoyed initial wide support in Washington. As the next part demonstrates, intense foreign competition and the need for balance of payments were ripe political conditions for the doctrine and the investment credit as its test case.

\textbf{B. Foreign Competition and Economic Race}

During the 1960s, economic growth had become the primary objective of the government for political and strategic reasons, arising from balance of payments considerations and an “economic race” with the Soviet Bloc. The U.S. government became concerned with its economic growth rate, which had fallen behind the Soviet Union, Japan, and Western Europe. Many foreign nations were subsidizing investments and allowing a more rapid cost recovery of new plants and equipment, in order to compete with foreign industries.\textsuperscript{136} There was a growing

\begin{itemize}
\item \textsuperscript{128} \textit{Id.} at 105-106. One way to alleviate this lag is through Presidential Executive spending action.
\item \textsuperscript{129} \textit{Id.} at 98 (“The lag of demand is likely to be particularly marked in the case of business taxpayers operating against long-term plans “)
\item \textsuperscript{130} \textit{112 Cong. Rec.} 19421 (1966) (statement of Senator Proxmire) (stating that Treasury estimated the average order-to-completion period for investment-credit-eligible equipment as 9-12 months, excluding buildings and structures, for which the period is much longer.)
\item \textsuperscript{131} \textit{See} Department of Commerce, OBE Release, 67-9 (Mar.9, 1967); \textit{National Industrial Conference Board, Survey of Capital Appropriations}, Table 2 (1967). Economist E. Cary Brown stated that the response of consumption expenditure to changes in personal income tax estimated is evidenced in two quarters, until tax action gives rise to changes in consumption. \textit{Hearings Before the Subcomm. on Fiscal Policy of the J. Econ. Comm.,} 90th Cong. 10 (1966) (statement of E. Cary Brown).
\item \textsuperscript{132} \textit{Tax Changes for Shortrun Stabilization, supra} note 110, at 238 (statement of Stanley S. Surrey) (claiming that the impact on the annual rate of GNP ranged between $1 billion and $2 billion per $1 billion of change in individual tax liability.).
\item \textsuperscript{133} \textit{The President’s Tax Proposals Hearings Before the Ways and Means Comm.,} 90th Cong. 598 (1967) (statement of Joseph A. Peachman).
\item \textsuperscript{134} \textit{Terborgh, supra} note 119, at 108.
\item \textsuperscript{135} \textit{Id.} at 184.
\item \textsuperscript{136} Richard N. Cooper, \textit{National Economic Policy in an Interdependent World}
consensus in politics, industry, and academia on the necessity to provide the equivalent of these foreign investment incentives to spur large-scale capital investments. The Chamber of Commerce emphasized that price and wage scales were not economically efficient compared to those offered abroad.\textsuperscript{137} Scholars called for the lowering of the corporate tax rate, claiming that higher tax burden put U.S. firms at a disadvantage for expansion and domestic production compared to their foreign competitors.\textsuperscript{138}

There was a general belief that the U.S. had been unable to do a great deal with provisional and restricted incentives, such as the immediate expensing rule, in insuring the modernization and replacement of productive facilities that were so sorely needed.\textsuperscript{139} Business leaders, such as the President of General Electric, warned that capital formation and economic growth in the U.S. during the 1950s was lower than ever: \textsuperscript{140}

Adding urgency to this task of modernizing our manufacturing plants is the newly-intensified challenge of world competition… But, Cold War aside, the realities of competition in today's world markets demand that we modernize those main aspects of public policy which affect economic growth. In such a re-examination, tax reform must come near the top of the agenda.\textsuperscript{141}

Professionals emphasized that, compared to other nations, U.S. industry suffered from inefficiency and a lack of modernized production methods.\textsuperscript{142} Many foreign plants were newer and more modern than their U.S. counterparts, which put American industry in an inferior competitive position and intensified the nation’s balance of payments problem.\textsuperscript{143}

These concerns played an important role in the government decision to inaugurate the investment credit.\textsuperscript{144} In 1962, U.S. Secretary of the Treasury, C. Douglas Dillon, testifying in favor of enacting the investment credit, stating:

If U.S. business firms are to be placed on substantially equal footing with their foreign competitors in this respect. It is essential...to our competitive position in markets both here at

\textit{Economy}, 76 \textsc{Yale L.J.}, 1273, 1288 (1967) (surveying the investment incentives granted by leading nations at that time, including the U.K., Germany, Belgium, Japan, etc.).

\textsuperscript{137} \textit{1961 House Hearings, supra} note 28, at 987.

\textsuperscript{138} \textit{Hearings on the Revenue Act of 1962, supra} note 96, at 3088-89 (statement of Dan Throop Smith) (“If our country is to get its rightful competitive share in the expanding income of the world, our business firms must be free to compete where production is taking place.”).


\textsuperscript{140} Gerald L. Phillippe, \textit{Taxes and Economic Growth}, 14 \textsc{TAX EXEC.}, 302, 304 (1962).

\textsuperscript{141} \textit{Id.}

\textsuperscript{142} John W. Cook, \textit{The Investment Credit: Investment Incentive and Countercyclical Tool}, 45 \textsc{TAXES} 227 (1967).

\textsuperscript{143} \textit{Id.}

\textsuperscript{144} Cooper, \textit{supra} note 136.
home and abroad, that American industry be put on the same basis as foreign industry. Unless this is done, increased imports and decreased exports will unnecessarily add to the burden of our balance of payments deficit.\footnote{145}

Under the leadership of its Chairman, Walter Heller, the Council of Economic Advisors (CEA) launched one of its most effective public campaigns ever witnessed. In the following years, New Economics became a dominant government philosophy of fiscal planning and action. Following the CEA’s recommendation, Congress enacted the investment credit in the hope of encouraging equipment and machinery purchase through an increase in their rate of return and cash flow from their investment.\footnote{146} From its inception, the investment credit attracted much criticism. The next part demonstrates that although the declared policy of the Administration was not to use the new investment credit as a countercyclical device, but to make it permanent.\footnote{147} But reality reflected the contrary. Businessmen were skeptical of President Kennedy’s aversion to an on-again-off-again investment credit, and did not believe that he would not restore the credit when capital spending fell again.\footnote{148} This created significant agency problem that eventually led to the demise of the investment credit.

III. FISCAL ACTIVISM IN FORCE: AN AGENCY PROBLEM

A. The Business Community’s Disapproval

In 1962, McGraw-Hill conducted a survey to predict future capital expenditures as a result of utilizing the investment credit. Businessmen responded that it would only raise their capital expenditure by 1%.\footnote{149} Nine out of every 10 companies that participated in the survey replied that they did not anticipate making use of the tax credit.\footnote{150} That same year, the National Industrial Conference Board conducted a similar survey of the largest manufacturing corporations to determine the effect of the tax credit upon capital investment trends. Here too, the survey reported a rather small expected increase in capital outlay; in the majority of the industries, the anticipated increase was under 1%.\footnote{151} A separate survey provided an even gloomier picture. The majority of firms indicated that they did not expect the new tax credit to have any influence on their capital investment decisions.\footnote{152}

\footnote{145}Hearings on H.R. 10650 Before the S. Comm. on Fin., 87th Cong., 83 (1962).
\footnote{146}Surrey, supra note 79.
\footnote{147}Cook, supra note 142 (holding both the accelerated depreciation and the investment credit as instituted as permanent parts of the tax code). \textit{See also}, \textit{Hearings on the Revenue Act of 1962, supra note 77}, at 2905-12 (statement of Walter A. Slowinski of the U.S. Chamber of Commerce) (“The Chairman: Well, it is intended to be permanent, I am confident of that.”).
\footnote{148}Kraus, supra note 1, at 61.
\footnote{150}\textit{Id.}
Business executives remained apprehensive regarding the abundant uncertainty in allowing the government flexibility when “it may prove desirable for the Congress to modify the credit from time to time, so as to adapt it.”153 They sought certainty. Accordingly, the National Association of Manufacturers described the new credit as a device intended for the manipulation and control of the U.S. economy.154

The temporary character of the new tax credit, and its declared purpose of countering economic cycles, had businessmen up in arms. Professionals, scholars, and the media described the investment credit as an “utmost liberal device,”155 a “sugar coating,”156 a “gimmick,”157 and an “outright gift” to its intended beneficiaries.158 The Rubber Manufacturers Association labeled it as an “unwanted federal subsidy,” arguing that it was a major departure from the general tax principles and an unjustified appropriation.159 The American Federation of Labor and Congress of Industrial Organizations referred to the investment credit as a “multi-billion dollar windfall that will not really contribute anything to our national goal.”160

The business community was in turmoil.161 In its recommendation to the President, the Chamber of Commerce argued that the new tax credit was unfair and unreasonably discriminatory between taxpayers within the business community in certain industries, and businesses that were in the position of making large investments that would not provide a sufficient stimulus.162 The Chamber’s representative argued that the new

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155 Wilkinson, supra note 100, at 500.
156 Daniel Candee Knickerbocker, Jr., The New Investment Credit, 8 PRAC. LAW. 43 (1962) (“The sugar coating on the President’s 1961 tax proposals was the so-called “investment credit”).
157 1961 House Hearings, supra note 28, at 987 (1961) (citing to a Business Week magazine article calling the investment credit a gimmick).
160 The Tax Recommendations of the President, supra note 154, at 1140-51.
162 Id. (“If there is to be a tax credit subsidy for investment in productive facilities, it should be given to all taxpayers in proportion to their investment in productive
credit also discriminated against small and marginal businesses because it only applied to firms with positive tax liability that could offset the credit.\textsuperscript{163} Instead, it proposed an overall liberalization of the tax depreciation allowance system and immediate expensing by eliminating the maximum limitation on the initial first-year allowance altogether.\textsuperscript{164}

For similar reasons, the small-business lobby also expressed its disapproval of the investment credit.\textsuperscript{165} It considered the credit as a mechanism aimed at larger businesses that were already capable of expansion.\textsuperscript{166} Small businessmen claimed that the new credit would not encourage their expansion, especially because it initially applied only to new property, which they could not often afford, compared to newly acquired, used property.\textsuperscript{167} They argued that instead of enacting a new apparatus, it would be far better to liberalize the existing system of depreciation and work toward a general reduction in income tax rates.\textsuperscript{168} In order for them to utilize the tax credit, they required strong borrowing power and positive tax liability. Businesses with losses or negative tax liability could not utilize the investment credit, but could carry it forward to a year where they incur a positive tax balance.

Political organizations, such as Americans for Democratic Action—one of the nation’s oldest liberal groups—also advocated against the new tax credit and for expansion of the immediate expensing. They urged the Ways and Means Committee to commit to liberalizing the depreciation system.\textsuperscript{169} They acknowledged that tax incentives were needed to encourage investors to assume risks, to develop new undertakings, and to expand existing businesses.\textsuperscript{170} Although some regarded the investment credit as nothing more than a temporary transitional measure,\textsuperscript{171} they recognized that, once enacted, tax preferences are hard to discontinue.\textsuperscript{172}

\textsuperscript{163} Id. ("...Marginal firms in large industries will probably not get the full advantage of the plan and this is unfortunate for they need it most."). \textit{Hearings on the Revenue Act of 1962, supra note 77, at 468} (statement of Walter A. Slowinski of the U.S. Chamber of Commerce); 26 U.S.C §1245, §1250. The Chambers sought the new credit an insufficient stimulus to offset the effect of the denial of capital gain treatment at a time of disposition of depreciable assets.

\textsuperscript{164} \textit{1961 House Hearings, supra note 28, at 987.}

\textsuperscript{165} Id. (statement of the Smaller Business Association of New England).

\textsuperscript{166} Id. ("the plan provides the greatest advantages to companies with adequate financing available for needed expansion; (2) the plan in granting a subsidy type of credit furthers a managed economy concept, which we abhor; (3) the plan has little application to non-manufacturers; and (4) the plan ignores our need for retention of earnings.").

\textsuperscript{167} Many small businesses purchased refurbished or used property. Others, that did not have access to loans and outside funding, used lease financing in order to obtain capital equipment. \textit{See 1961 House Hearings, supra note 28, at 987. See also, Hearings on the Revenue Act of 1962, supra note 77, at 468. See H. R. Rep. No. 1447, 87th Cong., 2d Sess. at 9 (1962); Hearings Before the Senate Committee on Finance on H. R. 10650, 87th Cong., 2d Sess. 2360, 3018 (1962).}

\textsuperscript{168} Revenue Act of 1962, Pub. L. No. 87-834, S. Rep. No. 87-1881 (statement of Charles B. Shuman, President, American Farm Bureau Federation)

\textsuperscript{169} \textit{1961 House Hearings, supra note 28, at 987.}

\textsuperscript{170} Id. ("...if tax incentives are made more and more attractive, investors will put more and more money into new plants and equipment.").

\textsuperscript{171} \textit{President’s Proposal to Repeal Investment Tax Credit and To Extend Tax facilities.").

\textsuperscript{172}
The investment credit was widely considered a big business tax break because it was made available not only to individuals and ordinary corporations, but also to large mutual savings banks, regulated investment companies, real estate investment trusts, etc. Accordingly, representatives from large firms, such as Honeywell Co., admitted that, although their companies would probably benefit from the new investment credit, it would not be used by companies that most needed it to make possible the expansion and rehabilitation of their equipment.\textsuperscript{173} The president of General Electric added, “With respect to the specifics of the investment credit plan, however, I do not think it can go unnoticed that most business executives have shown a distinct lack of enthusiasm.”\textsuperscript{174} He, too, saw a sign of climate change in Washington, and hoped for placing a higher priority on capital formation and modernization.\textsuperscript{175}

Nevertheless, over time, some of the skeptical business community leaders realized the potential of the investment credit in providing a solid support for investment in machinery and equipment, and in increasing productivity and growth.\textsuperscript{176} This shift was attributed to the fact that soon after its debut, an unprecedented demand for machinery and equipment occurred that exceeded the nation’s capacity to produce such goods. As a result, the government used the investment credit in various ways to react to the changing economic conditions. But prior to that undertaking, the next part illustrates another disadvantage of the investment credit that contributed to its repeal — its complex nature.

\textbf{B. Complex Administration}

Members of business groups repeatedly rejected the investment credit for being too convoluted and difficult to administer.\textsuperscript{177} Small business institutions, such as the House and Senate Select Committees on Small Business, used the investment credit’s complex nature in their attempts to persuade Congress to enact straightforward tax measures geared toward small business.\textsuperscript{178} They argued that the immediate

\begin{footnotes}
\footnote{Hearings on the Revenue Act of 1962, supra note 77, at 2905-12 (statement of Walter A. Slowinski of the U.S. Chamber of Commerce) (“When you start a subsidy, it is hard to stop it. We don’t stop subsidies.”).}
\footnote{1961 House Hearings, supra note 28, at 1537 (statement of Minneapolis-Honeywell Regulator Co). See also id. (statement of Owens-Cornino Fiberglass Corp.).}
\footnote{Phillippe, supra note 140.}
\footnote{Id. (“The basic problem is that the present provisions, developed during the Thirties and not basically changed since then...”).}
\footnote{Surrey, supra note 79, at 478.}
\footnote{Hearings on the Revenue Act of 1962, supra note 77, at 468 (statement of Walter A. Slowinski of the U.S. Chamber of Commerce); 1961 House Hearings, supra note 28, at 987.}
\footnote{Id. (“Such a minimum credit ... would not encourage small businessmen to improve their plant and equipment... to assist small business must provide a realistic means of enabling smaller enterprises to retain a larger proportion of before-tax earnings.”).}
\end{footnotes}
expensing rule was considered a better alternative, as it was simpler and easier to administer.\(^\text{179}\) Instead of keeping a record of depreciation deductions over years, immediate expensing allowed a write-off of the investment in the first year it was placed in service. Accordingly, the SBA and the small business congressional committees advocated for the expansion of immediate expensing limits to enable small businesses to retain and utilize pre-tax earnings.\(^\text{180}\) They mentioned that investment credit added various complexities when applied to pass-through entities, thus proposed to make it more small business-friendly.\(^\text{181}\)

The investment credit had various limitations and exclusions, exclusions within these exclusions, and different rates under different conditions. The recapture of the credit in the case of certain dispositions, and many other provisions, made it impossible to comprehend and administer.\(^\text{182}\) Treasury did not provide clear guidance for many of these intricacies.\(^\text{183}\) For example, one of the investment credit’s problems was its initial basis adjustment provision, also known as the “Long Amendment.”\(^\text{184}\) Any unused amount of credit could lower the tax payable in earlier or later years by means of carrybacks and carryovers, but contained many limitations and intricate rules.\(^\text{185}\) Other problems related to determining the useful life and time that the property was placed in service.\(^\text{186}\) The new credit restricted the type of property in which the investment must be made and the amount of tax liability for the year that could be offset by the credit.\(^\text{187}\) In addition, corresponding


\(^{180}\) Id.


\(^{182}\) J. W. Baldwin, Investment Credit Problems of the Oil and Gas Industry, 13 PROC. ANN. TUL. TAX INST. 429, 430 (1964).

\(^{183}\) To illustrate just one complexity, the carryovers and carrybacks rule of the unused portion of the credit were so convoluted that professionals testified that any 1962 unused credit could affect tax returns all the way through to 1973. Id.

\(^{184}\) The basis of property subject to the credit was reduced by the amount of the investment credit regardless of whether the credit was used immediately, via the carryback or carryover. These provisions are referred to as the Long amendment, after Senator Russell B. Long of LA who proposed them before the Senate Finance Committee. See 108 Cong. Rec. 16683-85 (daily ed. Aug. 27, 1962) and 108 Cong. Rec. 20580-83 (daily ed. Oct, 2, 1962).


\(^{186}\) Proposed Treas. Reg. §1.46-3(d) (1963). There was also lack of uniformity in the treatment of investment credit by the various states. See Report of Committee on State and Local Taxes, Bulletin of Section of Taxation, American Bar Association, p. 241 (July, 1963).

sections were added to reduce the amount of the credit, according to the useful life of such property.

Accordingly, many business leaders\(^{188}\) industries associations,\(^{189}\) unions and labor organizations\(^{190}\) claimed the varying percentages schedules made the investment credit too complicated. Business executives from large companies, such as the Edison Electric Institute, warned of the tax credit’s overly complex administration. In his article on the 1962 tax reform, the President of General Electric commented that the new device is overloaded with special features and dispensations.\(^{191}\) Professionals opined that the new investment credit was terribly complex and, in many respects, represented a departure from the conventional income tax system.\(^{192}\)

Scholars were worried that the new credit would generate wasteful tax-planning and litigation activity.\(^{193}\) The tax credit’s limitations on income tax liability, numerous exclusions, complex carrybacks, carryover and recapture rules made it prone for abuse. Political figures, such as the Chairman of the tax-writing Finance Committee, Senator Byrd (D-VA), professed that the tax credit was “wrong in principle and unnecessary,” and “one of the largest loopholes that has ever been written into the tax law.”\(^{194}\) Furthermore, Senator Williams (R-DE), declared that this credit was “too complicated for a Harvard professor to understand.”\(^{195}\)

However, the vast opposition to the investment credit by the business community, professionals, and politicians did not stem solely from the reasons stated above. Indeed, the credit was thought a complex tax subsidy. But these debates did not occur in a historical vacuum. Another major reason for the instability and eventual downfall of the investment credit is the emergence of fiscal activism. While it was not clear whether the credit indeed created new purchases or simply accelerated their timing, the next part mirrors these difficulties while describing the frequent use of the investment credit in the 1960s-1980s to direct economic change.

\(^{188}\) Phillippe, supra note 140. See generally, the U.S. Chamber of Commerce, the National Association of Manufacturers, the Controllers Institute and the Machinery and Allied Products Institute, cited in Glasmannt, supra note 181.

\(^{189}\) 1961 House Hearings, supra note 28, at 1537.

\(^{190}\) Id. (statements of Clyde McFarlin, U.S. Indep. Tel. Ass’ns. and John Clark, President, Int’l Union of Mine, Mill & Smelter Workers) (“In this connection we feel strongly that if any credit is granted it should be made to apply to all business taxpayers….the incentive tax credit is too complex, discriminatory, and difficult to administer.”).

\(^{191}\) Phillippe, supra note 140.

\(^{192}\) Knickerbocker, supra note 156.


C. An Era of Trial and Error

1. The First Years

Indeed, as Figures IV-V in the Appendix demonstrate, in the years that followed the enactment of the investment credit, the nation witnessed an increase in capital formation rates, a rise in Gross National Product (GNP) and a decrease in unemployment rate. Business investment expenditures rose to record levels and surpassed the GNP at that time.196 Although it was not clear whether these changes resulted from the adoption of the tax credit or other political and economic conditions, new economists celebrated this upward trend as proof of the validity of their new fiscal policy.197

The investment credit was depicted as a powerful cyclical device, and a prevailing method to spur changes in the market by stimulating investments in machinery and equipment.198 However, while the Kennedy administration had intended the investment credit to be permanent,199 the Johnson administration believed it to be a temporary, transitional measure that had been created to resolve economic deficiencies in previous years.200 It was reluctant to extend the investment credit because of its contracyclical use and its ambivalence toward New Economics.201

Once the justification for providing investment incentives no longer existed, with businesses overspending on capital investments, the Johnson administration sought to minimize their scope.202 Increased involvement in the Vietnam War intensified this picture. Sharper defense costs further accelerated the rate of economic activity.203 The tax

197 Id. at 479.
198 Tax Changes for Shortrun Stabilization, supra note 110, at 11-12 (statement of Nathaniel Goldfinger).
199 Cook, supra note 142 (holding both the accelerated depreciation and the investment credit as instituted as permanent parts of the tax code.).
203 Surrey, supra note 79, at 478 (describing new economists being baffled with this economic overproduction).
credit added unsuitable emphasis to that boom in capital outlays, which created inflationary demand pressures. The record pace of investment in plants and equipment was creating excessive investment demands and considerable inflationary pressures. Efforts to curb these pressures necessitated restraining this capital-spending boom.

2. 1966—Suspension

Hearings of the Subcommittee on Fiscal Policy on tax flexibility demonstrated a growing emphasis on the concept of using the federal tax system to achieve economic objectives, which won increasingly wide congressional acceptance from 1962 to 1966. The committee focused on goals such as economic growth, price stability, and reduced unemployment. Tax policy had been playing a growing role in the nation’s overall economic policy. Realizing that there was a need to restrain the over-performance of the economy, New Economists quickly assumed a flexible approach, utilizing tax policy as a temporary stabilizing device. They started using the investment credit to achieve these goals. Accordingly, the CEA acted to suspend the investment credit in 1966.

Proponents of the suspension of the investment credit explained that a temporary holdup would be useful in encouraging businesses to delay capital investments in the current economic state, until a later time that might be more suited to the economic conditions of the market. Those who supported the retention of the investment credit warned against introducing more uncertainty to the market, either by creating a stampede to quickly deliver equipment before the effective date of the suspension, or by postponing expansion plans until the suspension period ended.

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204 *See Tax Changes for Shortrun Stabilization, supra note 110, at 211-217* (statement of Nathaniel Goldfinger).


206 *Id.* at 480.

207 *The role of the government in maintaining and balancing stable market growth was also observed in foreign countries’ experience of achieving success in establishing a series of plans to correct instability and a rise in standards of economic performance. See, generally Kenyon E. Poole, *Some Aspects of the Role of Government in Stable Growth, 20 U. FLA. L. REV. 464 (1968).*

208 *Surrey, supra note 79, at 478.*


210 *Id.* at 27.

211 *Id.*
Only a few years after its enactment, the investment credit’s biggest adversary, the Chamber of Commerce, began to advocate for making the tax credit a permanent part of the tax structure. Once its constituents realized the benefits of the new credit, concerns for certainty and neutrality were pushed aside. These different viewpoints demonstrated the insufficient knowledge and inadequate analysis of the effects of the investment credit as a countercyclical tool and an economic stabilizer. The few surveys that were conducted were limited and displayed little effect on the business decisions of modernizing facilities and providing incentives for capital investments.

Ultimately, Congress temporarily suspended the investment credit from 10 October 1966 through 31 December 1967. The role of the Tax Adjustment Act of 1966 was to employ fiscal restraint for anti-inflationary purposes. For the first time in history tax policy was openly utilized as a short-range economic stabilizer as opposed to its revenue raising role in previous decades. In a press conference, President Johnson declared “[w]e won’t give you a bonus to do what we don’t want you to do.” The next section illustrates the contrary.

3. 1967—Restoration

Contributing to the agency problem of the investment credit was the objection of some congressional representatives to submit to a theory that required them to change the laws and direct the market so frequently. Even when suspending the investment credit, the government was already contemplating the early termination of the suspension, and therefore left open the prospect of its restoration. Since the key reason for suspending the tax credit was to slow down all equipment purchase activity, the suspension period covered not only property actually built or acquired, but also property ordered during the moratorium period.

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213 Tax Changes for Shortrun Stabilization, supra note 110, at 145 (statement of Nathaniel Goldfinger).
214 Cook, supra note 142.
215 See infra Part III.B.3.
217 See generally Surrey, supra note 79, at 478.
218 Statement, Press Conference of the President, September 8, 1966. In his 1966 Economic Report President Johnson added, “... improvement of our tax system is a continuing need which will concern this Administration and which deserves the support of all Americans.” See 112 Cong. Rec. 1266, 1270 (daily ed. Jan. 27, 1966).
220 Suspensions of Investment Credit and Accelerated Depreciation: Hearings Before the Committee on Finance on H.R. 17607, 89th Cong. 382 (1966).
221 That would have been unlikely had companies been able to continue to place orders for manufacture and merely defer the delivery dates.
During the suspension, capital investments were frozen in anticipation of its restoration.\textsuperscript{222} Massive cancellation of orders of equipment and machinery followed by a period of credit holdup. The growth rate of investment in plants and equipment dropped to 4\% in 1967, as opposed to 14-17\% in previous years.\textsuperscript{223} The suspension impacted several industries, which saw a fall of over 80\% in the number of orders of tools and machinery since it went into effect.\textsuperscript{224}

The reinstatement of the tax credit in 1967 came in a period of legislative drought in the federal income tax area.\textsuperscript{225} The Johnson administration pushed for tax increases\textsuperscript{226} relying on the CEA and leading economists, such as Joseph Peachman, to support its fiscal policy.\textsuperscript{227} In March 1967, the administration was back in Congress with a restoration bill.\textsuperscript{228}

Eventually, the suspension lasted only 5 months and was brought back on 31 May, 1967.\textsuperscript{229} In addition to ending the credit’s suspension period ahead of the scheduled date, the restoration bill introduced changes to the limitations of the amounts of the tax credit, and for the effect of the suspension provisions to be applied retroactively to March 9, 1967.\textsuperscript{230} Albert Karust summarized this period stating, “While the

\begin{itemize}
  \item \textsuperscript{222} See \textit{Hearings on H.R. 6950 Before the House Comm. on Ways and Means}, 90th Cong., 1st Sess. 6-7 (1967)(testimony of Secretary Fowler).
  \item \textsuperscript{223} \textit{Cong. Rec.} S. 3415-3416 (Mar. 9, 1967).
  \item \textsuperscript{224} \textit{Cong. Rec.} S.3251 (Mar. 9, 1967) (reporting that industries, such as railroad equipment manufacturers, experienced a drop in orders of 78\%-84\%).
  \item \textsuperscript{225} Zeitlin, Gardner, Galin, supra note 206, at 724.
  \item \textsuperscript{227} See Id. at 518-25 (statement of Joseph A. Pechman, Director of Economic Studies, the Brookings Institute).
  \item \textsuperscript{228} President’s Message Relative to Restoration of Investment Credit, H.R. 81, 90th Cong., (1967). Although the bill was swiftly passed in the House, the Senate Finance Committee disagreed with the changes made in the House version, which retroactively expanded the types of cases in which the tax incentives were to be made available. The committee reported that the House version of the bill was discriminatory against taxpayers who postponed investments compared to taxpayers who ordered equipment or began construction during the suspension period. \textit{See S. Rep. 90-79, at 2 (1967).}
  \item \textsuperscript{230} Gerald J. Holtz and Harold R. Jenkins, \textit{Restoration of Investment Credit and Accelerated Depreciation}, 45 \textit{TAXES} 660 (1967)(reporting that the suspension period was shortened to Mar. 9, 1967, instead of Dec. 31, 1967, and eventually took place from Oct. 10, 1966 to Mar. 9, 1967. The limitation on the amount of investment credit, which may be claimed in any one year was increased from 25\% to 50\%, as of Mar. 9, 1967.).
\end{itemize}
adoption of the bill mercilessly ended a fiasco, it did not terminate the headaches of the episodes.\textsuperscript{231}

4. 1969—Repeal

Prior to the suspension of the investment credit, studies on the future effect of such temporary abrogation on capital investments had cast considerable doubts on the effectiveness of the tax credit in spurring capital investments.\textsuperscript{232} These studies showed only a modest anticipated reduction, if any, among the largest manufacturing companies at that time. It was argued that the effect of the tax credit was noticeable, to some degree, in marginal industries and on small businesses.\textsuperscript{233} This was not sufficient for the administration to sustain such a mechanism, which was largely portrayed as a business subsidy.\textsuperscript{234}

Northwestern University economist Kanyon Poole emphasized, at that time, that it is not clear that special investment tax incentives are truly needed. He argued that investments and savings are not necessarily created independently and as an outcome of tax inducements.\textsuperscript{235} Tax Professionals began to question the effectiveness of utilizing the investment credit as an intermittent apparatus.\textsuperscript{236} In his role as Assistant Secretary of the Treasury for Tax Policy at that time, Stanley S. Surrey promoted the enactment of the new tax credit.\textsuperscript{237} However, after stepping down from his position, Surrey criticized the use of the tax credit as a countercyclical device.\textsuperscript{238} Although the investment credit was kept under the radar in other countries,\textsuperscript{239} the legislative process in the U.S. made it impossible to avoid signaling to the market when the tax benefit was scheduled to be suspended or restored. This inherently harmed the nature and effectiveness of the tax measure.\textsuperscript{240} Support in Fiscal activism began to drop.

\textsuperscript{231} Kraus, supra note 1, at 61.

\textsuperscript{232} Investment Statistics, Special Survey: The Suspension of Tax Incentives-Impact on Capital Investment (Sept. 1966) (The National Industrial Conference Board surveyed 1,000 of the largest manufacturers on future effects of the temporary suspension of the tax credit and found an anticipated 1.3%-2.8% reduction.).

\textsuperscript{233} Cook, supra note 142.

\textsuperscript{234} Id. at 232.

\textsuperscript{235} Poole, supra note 208.

\textsuperscript{236} Cook, supra note 142

\textsuperscript{237} Tax Changes for Shortrun Stabilization, supra note 110, at 243 (statement of Stanley S. Surrey)(“These effects would cover a wider range of investment-including inventories and accounts receivable-than would a change in the investment credit.”). Later on, Surrey argued against utilizing the credit as a countercyclical device since the effect of the investment credit is also directly influenced by corporate tax changes and indirectly by individual income tax rates.

\textsuperscript{238} Surrey, supra note 79, at 481.

\textsuperscript{239} Tax Changes for Shortrun Stabilization, supra note 110, at 60 (statement of Robert A. Gordon)(“In a different form, the Swedish government has been using tax incentives to investment for a number of years as an integral part of its stabilizing fiscal policy.”)

\textsuperscript{240} Id. (“By the time whatever measures may have been needed gets past Congress, the opposite probably is needed. This is what happened the last time the investment credit was suspended. The suspension was proposed on Sept. 1, 1966, and enacted in November, retroactive to Oct. 10.”).
The growing U.S. participation in the Vietnam conflict, with peak involvement in 1968, continued to create a build-up in capital spending and deployment of war-related industries. In 1969, investments in new plants and equipment were at a high point. The investment credit augmented these inflationary pressures by stimulating demand even further. As a result, the Treasury sought to place a higher national priority on the need for general taxpayer relief.\footnote{Staff of J. Comm. on Internal Revenue Taxation, J. Comm. on Ways and Means, 91st Cong., Summary of Problems Presented in Statements Submitted to Committee on Ways and Means with Respect to Treasury Proposal to Repeal the Investment Credit 1-6 (Comm. Print 1969).} In his tax reform message on April 21, 1969, President Nixon supported the repeal of the investment credit describing it as “a Democratic measure” and an “unwarranted and unneeded” subsidy to business.\footnote{Accompanied it with an extension of the 10% surcharge to 1970 in order to make funds available for other high-priority programs. Id.}

As a policy matter, President Nixon opposed the investment credit viewing the justification for its use only as an emergency and transitional measure to correct deficiencies in the tax structure on a temporary basis.\footnote{President’s Proposal to Repeal Investment Credit and To Extend Tax Surcharge and Certain Excise Tax Rates: Hearings Before The H. Comm. on Ways and Means, 91st Cong. 187-90 (1969) (statement of Rep. Edward Garmatz, Member).} Small business lobby began to voice their support and even expressed concerns that repeal of the investment credit without reforming the capital recovery system would impose a substantial and unwarranted tax increase.\footnote{Tax Reform Act of 1969: Hearings Before S. Comm. on Finance, 91st Cong. 3962-66 (1969) (statement of Carl M. Halvorson, President of the Associated General Contractors of America).} They used the power of small business rhetoric in their attempt to avoid the repeal.\footnote{See also Review of Small Business Administration’s Programs and Policies - 1969, 91st Cong. 242-44 (1969) (Recommendation of The Smaller Business Association of New England to Increase First Year Depreciation Allowance, S. Comm. on Small Bus).} Once more, they suggested granting immediate expensing allowance, irrespective of the size of the investment or the useful life of depreciable property, as a step toward expanding its application to all businesses.\footnote{For example, the Machinery Dealers National Association—a trade association of small businessmen in the used-machine tool industry—also appeared before the Senate Finance Committee hearings on the Tax Reform Act of 1969. They protested that the Act did not include tax revisions to assist small businesses while advocating for the reinstatement of the investment credit for small businesses only, stating that the impact of the repeal would be devastating to the sales of their machine tools and proposed the increase of immediate expensing to a more realistic level. The SBA echoed these concerns, and suggested a limited credit be permitted only for small businesses. See, Tax Reform Act of 1969, H.R. 13270, S. Comm. on Fin., 215-21 91st Cong., (Comm. Print 1969) (Statement of Saul Pearl president of the Machinery Dealers National Association) (“In our judgment the limited reinstatement of the investment credit would be the simplest and most effective means of preserving many of our nation’s small businesses.”).}
In view of the termination of the tax credit, the joint committee repeated suggestions to expand the immediate expensing and eliminate its dollar limitation. Effective April 18, 1969, Congress repealed the investment credit with both President Nixon and the Committee on Ways and Means declaring that the investment credit “has fulfilled its purpose of increasing investments during a period of slack demands and has outlived its usefulness as a stimulant to the economy.” The next section reveals that this repeal, too, did not last long. The experimentation in fiscal activism was very still underway.

5. 1971-1975—Reinstatement and Increase

During 1970, inflationary pressures grew stronger than at any time since the Korean War, and were not restricted to domestic monetary and fiscal policies; there had been an ongoing worldwide forceful spike in consumer product. With the move away from the gold standard, the dollar decreased in value, and food, agricultural products, and basic industrial materials became in short supply. Credit demands were unusually heavy, and interest rates were at extremely high levels, at over 8%. Calls to restore the investment credit were accompanied by pleas for fiscal restraint and a compulsory savings plan.

The Federal Reserve warned that “violent price increases that stem from such sources cannot readily be handled with customary weapons of economic stabilization policy” Refusing to become dogmatically attached to the idea of fiscal activism, President Nixon adopted a pragmatic approach. He began to recognize the New Economics theory’s political appeal and its use in attaining certain economic

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Committee on Ways and Means with Respect to Treasury Proposal to Repeal the Investment Credit, 91st Cong. 1-6 (Comm. Print 1969).

247 Staff of J. Comm. on Internal Revenue Tax’n, J. Comm. on Ways and Means, 91st Cong., Summary of Problems Presented in Statements Submitted to Committee on Ways and Means with Respect to Treasury Proposal to Repeal the Investment Credit 1-6 (Comm. Print 1969). See also Tax Reform Act of 1969: Hearings Before the S. Comm. on Fin., 91st Cong. 961-66 (1969) (statement of Rep. Abner J. Mikva, Member) (“Machine tools today that are used even by small companies cost as much as $400,000. The average small company in the tool and die… machine tools costing many thousands of dollars.”)


250 On August 15, 1971 President Richard Nixon ended the international convertibility of the dollar to gold, which resulted in the so called “Nixon Shock”. There was no correspondent plan put in place to revalue currencies until more than a year later. Id.


252 Id. (“Additional fiscal restraint is also needed at this time… investment credit or a compulsory savings plan—that could be quickly reversed”).

253 Id. at 569.

objectives. Following the CEA recommendation, he announced a series of fiscal policy actions in line with the New Economics policy. \textsuperscript{255}

As a first step, President Nixon put in place a price control program on certain foods, wages, and domestic goods in order to moderate inflationary pressures. Second, he instructed the Federal Reserve to restrain monetary policy and limit Federal expenditures. Finally, he reinstated the investment credit, and while the administration recommended reinstating a 10\% credit, Congress restored the credit at its historical 7\% level \textsuperscript{256} In his message to the nation, President Nixon presented the investment credit as a 10\% job development credit. He justified these actions in the hope of attaining job development and improving international competitiveness and the nation’s balance of payments. \textsuperscript{257} Scholars commented that a bloc of pro-business votes made that legislative process, including the restoration of the investment credit, politically effortless. \textsuperscript{258}

Economic recovery began to occur in early 1971 and gained considerable momentum during 1972. Employment and incomes levels increased strongly; sales and new orders gradually improved, creating an environment of moderate price increases. \textsuperscript{259} The rate of expansion in aggregate economic activity rose further in the closing months of 1972, and rapid expansion continued into 1973. Production of goods and services increased by more than 6\%, and the rate of product exports increased by 44\%. \textsuperscript{260} Spending on new plants and equipment started an upward trend in 1972, rising by around 4\% after declining by approximately 6\% in 1971. A survey held by Department of Commerce indicated an anticipated 13\% increase in business capital investments in 1973. \textsuperscript{261} The Federal Reserve acknowledged a number of factors that assisted this economic recovery and gain in business capital spending, amongst them the restoration of the investment credit in late 1971. \textsuperscript{262}


\textsuperscript{257} Hearings on the Revenue Act of 1971 Before the Senate Finance Comm., 92d Cong., 6-7 (1971).

\textsuperscript{258} Gerard M. Brannon, The Revenue Act of 1971- Do Tax incentives Have New Life?, 14 B.C. INDUS. & COMM. L. REV. 891, 897 (1973) (arguing Congress contained a bloc of pro-business votes as well as a bloc of liberal votes that enabled the quick enactment of the investment credit.).


\textsuperscript{260} Statement by Arthur F. Burns, supra note 251.


\textsuperscript{262} Id. See also The Federal Reserve, Federal Fiscal Policy 1965-72, 59 Fed. Res. Bull. 383, 395 (1973) (“the reinstitution of the investment credit in December 1971 was a contributing factor to the fast economic growth that was experienced in 1972.”).
Arthur F. Burns, Chairman of the Federal Reserve Board, proposed the permanent alteration of investment credit, in accordance with countercyclical considerations, but his proposal was stymied by the Nixon administration, which refused to fully commit to New Economics activism.

From January 1973 until December 1974, the world experienced one of its major stock markets downturns in modern history. This market recession was exacerbated in November 1973, when a spike in oil prices occurred as a result of an oil embargo issued by the Organization of Arab Petroleum Exporting Countries against the U.S. for its involvement in the Middle East conflict. The sharp increase in oil prices, coupled with high government spending due to the Vietnam War, led the nation to a period of 3 years of stagnation. Figure IV in the Appendix illustrates that stagnation, as reflected in new capital equipment investments. The U.S. economy’s GDP growth dropped to 2.1%, and inflation rates soared in 1972 to 12.3% in 1974. In 1974, in order to curb inflation and augment the effect of the investment credit on spurring capital investments, President Ford recommended that investment credit be made refundable, though was unsuccessful.

By 1975, the prices of industrial raw materials had begun to decline and employment and production had decreased rapidly. Unemployment had risen sharply to over 7% of the labor force. Accordingly, the administration went on to increase the extent of the investment credit to temporarily boost capital demand and to encourage greater expansion in monetary and credit. In the Tax Reduction Act of

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265 See Davis, E. Philip, Comparing Bear Markets – 1973 and 2000, 183 NAT'L INST. ECON. REV. 78, 89 (2003); Companies Take Over the Takeover Game from Flashy Raiders, WALL ST. J., Jan. 25, 1988, at 1 (describing how low prices resulting from the market crash were followed by hostile corporate takeovers).


268 Davis, supra note 265.


271 Id. at 62.
1975 the administration proposed a major tax cut coupled with a temporary increase of the investment credit from 7% to 10% of the cost of qualified property.\(^{272}\) The administration justified these tax changes in helping to stimulate the economy by providing more jobs and moderating inflation by improving the capacity and efficiency of industrial plants.\(^{273}\)

By mid-1975, the economy had recovered and returned to its normal capacity. Nevertheless, businessmen and professionals continued to call for permanent extension of the investment credit.\(^{274}\) They argued that while the credit provided a substantial incentive for business to make investment in plants and equipment, its on again-off again character made it an unreliable factor in facility planning.\(^{275}\) Congress responded by enacting the Tax Reduction and Simplification Act of 1977, declaring it aims to provide economic stimulus, to increase consumer spending, to expand production of goods and services, and to reduce unemployment.\(^{276}\) As a compromise, the act kept the investment credit temporarily at its 10% level.\(^{277}\)

6. Final Years

In 1979, an increase in Iranian oil prices created a worldwide energy crisis.\(^{278}\) Spiking oil prices led the government to tighten its monetary policy to control inflation, and a short recession followed during 1981-1982. Accordingly, the Senate Finance Committee recommended increasing the investment credit to stimulate capital formation and improve the nation’s competitiveness in international trade.\(^{279}\) Yet, skepticism about fiscal activism kept the investment credit at its previous levels for several years.


\(^{273}\) Statement by Arthur F. Burns, supra note 270, at 63 (“But, while the Federal Reserve recognizes all this, we are also mindful of the lesson of history that rapid growth of the money supply will lay the base for a new wave.”).

\(^{274}\) Francis P. Carolan and Timothy C. Sentner, Added Potential in the Investment credit, 28 TAX EXEC. 222 (1976) (the writers are CPAs that argue that investment credit is the most important measure the Federal government took to assist businesses in obtaining capital); John C. Argue, The Investment credit After the Tax Reduction Act of 1975, 51 L.A. B.J. 194 (1975) (the writer is a law partner that describes the investment credit as very significant for the general business-professional community.).

\(^{275}\) W. Bruce Thomas, How to Increase Capital Formation, 29 TAX EXEC. 1 (1977)(In this short article Mr. Thomas, who is the Executive Vice President-Accounting Service, United States Steel Corporation, calls for increasing measures to create capital, including increasing the investment credit to 12% and making it permanent.).


\(^{279}\) The Senate Finance Committee declared that “present rules for determining depreciation allowances and the investment credit need to be replaced because they do not provide the investment stimulus that is essential for economic expansion.” S. REP. No. 144, at 47 (1981).
The most sweeping tax legislation in the history of the Internal Revenue Code to this day was manifested in the Tax Reform 1986 Act. This act reflected a major shift in tax policy, which at that time, focused on simplicity, fairness, equity, and economic neutrality. Support for a "fairer" tax code and tax neutrality received growing bipartisan support. In these years, we witness a shift in tax policy to a philosophy that investment decisions should be based on economic rather than tax incentives. The main advocates of this policy were Treasury Secretary James A. Baker III, and Speaker of the House of Representatives Congressman Thomas P. O'Neill, Jr., the latter noting:

I would like to think of the economy at all times, but I have to think of the national interest. We have to think of fairness. We have to think of what the people really want. Is it right? It is right that corporations of America should pay no taxes, that the wealthy of America should find loopholes? The answer is no…It is a voluntary tax code that we have seen erode.

The 1986 tax reform focused on lowering rates and expanding the base by eliminating many tax preferences. To compensate for the losses in revenue caused by individual income tax reduction and corporate rate reduction, the 1986 Act repealed a host of exclusions, deductions, and credits primarily used by corporate taxpayers. It aimed to move the income tax base toward a cost recovery system that improved the measure of income in terms of receipts less the cost of income production. Prior to the enactment of the 1986 Act, the revenue loss estimates from the investment credit for 1986 were projected at $30.9 billion, which made it an obvious target for repeal.

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282 Gleckman and Berger, Tax Reform-Long Term, A Streamlined Code Will Bolster The Economy, But Short Term? BUS. WEEK, Sept. 1, 1986, at 55 (citing Secretary Baker remarking “This is a very significant change. We're going to have a far more efficient system than we have now.”).
283 65 Cong. Digest 44 (Feb. 1986).
286 Simmons, supra note 284. Opponents of the repeal of business incentives, such as Congressman Marjorie S. Holt, opposed the effect such action would have on the economy. See 65 Cong. Digest 58 (Feb. 1986) (“My concern is the economic consequences of the legislation, and I have concluded that it will retard capital formation and investment, restrict economic growth, and cause higher unemployment.”).
287 See CONG. BUDGET OFFICE, TAX EXPENDITURES: CURRENT ISSUES AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1982-86, 81-84 (1981). For 1990, the revenue loss was projected at $8 billion. See STAFF OF J. COMM. ON TAX’N, 99TH Cong.,
The agency problem of the investment credit, its complexity, and skepticism regarding its effect on the economy reinforced the notion that this measure should be put to rest. 288

The immediate expensing rule was left intact for its small business affiliation and relatively minor revenue impact. 289 Even before President Reagan had signed the 1986 Act into law, lobbyists and other interest groups acted to reinstate the investment credit without much success. 290 In proposing to repeal the investment credit, the Ways and Means Committee reasoned that it did not accomplish its intended purpose, and did not stimulate capital investment to a degree sufficiently significant to produce economic growth. 291 For the long term, the investment credit merely shifted the timing of equipment purchases that would have taken place regardless of the credit. 292 On October 22, 1986, the Tax Reform Act put an end to the controversial history of the investment credit.

IV. CONCLUSION

History teaches us many important lessons. Here the message is loud and clear. Fiscal activism is a pill difficult to swallow. The investment credit was not the typical tax credit; it had a more onerous calling. It served as an agent of far-reaching measures to influence the economic market. In times of mounting foreign competition and inflationary pressures, it meant to function as a countercyclical mechanism as part of the administration’s experimentation in New Economics theory. It marked the transformation of the tax system from a revenue-raising device to an economic stimulus instrument. The decreasing confidence in government fiscal activism led to the repeal of the investment credit. Conversely, Congress continuously extended and expanded the

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288 Tax Proposals Contained in the President’s New Economic Policy: Hearings Before the House Committee on Ways and Means Regarding The President’s Proposed investment Credit (1971)(statement of James S. Fralick, Assistant Professor of Economics at Fordham University) (detailing the various credibility problems that investment credit has presented in history.).

289 Bolling, et al., supra note 284. See also Holtz-Eakin, supra note 278, at 80 (“the elimination of the investment credit (ITC) results in an asymmetric treatment of investment in physical capital and investment in research and development.”).

290 Joan C. Szabo, Welcome to Tax Reform, 74 NATION'S BUS. 22 (Nov. 1986). See also Howard Gleckman, This Is Not the Last Chapter in Tax Reform, BUS. WEEK, Sept. 1, 1986, at 64.


292 Id.

293 26 U.S.C. §§ 46-48 (amended 1986) (technically, these sections were "amended" in 1986, but they de facto were repealed).
immediate expensing rule though it remains unclear it has been fulfilling its purpose.

History also demonstrates that the perpetuation of the immediate expensing was due to the proverbial “small business” in its title. It was repeatedly endorsed as a small business measure.\textsuperscript{294} More so today, the topic of small business remains in the center of congressional attention.\textsuperscript{295} Regulatory compliance costs, credit problems, and the federal tax burden on small businesses remain on the political agenda. Current literature has shown that small business favoritism cannot be justified on economic grounds and, in fact, creates more economic harm than good.\textsuperscript{296} Nevertheless, declarations of politicians promising benefits to the “little guy” to win the public vote continue to persist.\textsuperscript{297} The path dependence of the immediate expensing rule is locked in an inefficient route. The House and Senate Select Small Business Committees and the Small Business Administration frequently propose and engrave small business legal preferences, reflecting a heavy investment by our legal system that outweighs any advantages from possible change.\textsuperscript{298}

The anomaly of the immediate expensing and the investment credit narratives is pertinent today. Currently Congress is debating several proposals put forth to reform the business tax regime. Among those

\textsuperscript{294} In 1978, the house reported on depreciation for small business that, under present law, there are no special provisions exclusively applicable to the depreciation of assets by small businesses. It admitted that, although not limited to small businesses, immediate expensing was enacted to provide a special incentive for small businesses. \textit{See} Pub. L. 95-600, Revenue Act of 1978, H. Rep. No. 95-1445. The Senate report on Economic Recovery Act of 1981 reiterated the fact that under present law there are no special provisions specifically applicable to depreciation of assets by small business. \textit{See} Pub. L. No. 97-34, Economic Recovery Act of 1981, S. Rep. No. 97-144.


\textsuperscript{297} The Joint Committee on Taxation and the Treasury Department’s Office of Tax Analysis estimated the federal revenue cost of all the small business tax preferences to exceed $11 billion in FY2013. \textit{See} GARY GUENTHER, CONG. RESEARCH SERV., RL32254, SMALL BUSINESS TAX BENEFITS: CURRENT LAW AND MAIN ARGUMENTS FOR AND AGAINST THEM (2013).

\textsuperscript{298} \textit{See generally} Douglas Holtz-Eakin, \textit{Should Small Businesses Be Tax-Favored?} 48 Nat’l Tax J. 387, 387 (1995) (asserting that constructing a case of systematic favoritism of small businesses is quite difficult, especially through the tax code); See also \textit{supra} note 16, at 28 (1996) (estimating the cost of annually subsidizing small business to be $5 billion). \textit{See also infra Part III.}
proposals is Chairman Camp’s suggestion to increase the immediate expensing limits and make it permanent.\textsuperscript{299} Similarly, President Obama’s proposal recommends making the immediate expensing rule permanent and allowing the entire cost of any qualified investments instantaneously deductible.\textsuperscript{300}

On the other hand, over the years there has been little empirical analysis of the effects of investment tax incentives. Although it appears that their future is secure for the time being, studies on the effectiveness of investment tax incentives in spurring investments, whether through deductions or credits, remain inconclusive.\textsuperscript{301} In fact, one study revealed only 10\% of the firms that claimed accelerated depreciation recently admitted that these preferences played a decisive role in their investment decisions.\textsuperscript{302} The efficiency of such measures should be reevaluated to ascertain if they actually advance stimulus objectives; if they do not, they should face the same fate as the investment tax credit.

This Article hopes to instigate further discussions on the efficacy of tax measures in achieving their intended purpose. Wilbur Mills forcefully argued against the use of the tax system to affect investment behavior without proper accountability.\textsuperscript{303} As time passes, he argued, it is essential that measures be tested against their intended goals. It is time we reexamine the equitability and desirability of many tax incentives, whether deductions or credits. Future studies should evaluate their efficacy as economic catalyst, compared to other direct alternatives.

* * *


\textsuperscript{300} \textit{The President’s Framework for Business Tax Reform, supra note 19}, See also Guenther, \textit{supra} note 93. Obama proposed to allow businesses of all sizes to expense all qualifying capital expenditure with 100\% bonus depreciation.

\textsuperscript{301} Guenther, \textit{supra} note 11 (concluding that available evidence indicates that the expensing allowances probably have had no more than a minor effect on business investment.).

\textsuperscript{302} \textit{Id.}

APPENDIX

FIGURE I:
Historical Maximum Allowance and Investment Limitations of Immediate expensing from 1958 to 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Maximum Expensing Allowance</th>
<th>Maximum Cost of New Equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1958-1981</td>
<td>20% $10,000</td>
<td>---</td>
</tr>
<tr>
<td>1982</td>
<td>$5,000 ---</td>
<td>---</td>
</tr>
<tr>
<td>1983</td>
<td>$5,000 ---</td>
<td>---</td>
</tr>
<tr>
<td>1984</td>
<td>$7,500 ---</td>
<td>---</td>
</tr>
<tr>
<td>1985</td>
<td>$5,000 ---</td>
<td>---</td>
</tr>
<tr>
<td>1986</td>
<td>$5,000 ---</td>
<td>---</td>
</tr>
<tr>
<td>1987-1992</td>
<td>$10,000 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>1993-1996</td>
<td>$17,500 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>1997</td>
<td>$18,000 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>1998</td>
<td>$18,500 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>1999</td>
<td>$19,000 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>2000</td>
<td>$20,000 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>2001-2002</td>
<td>$24,000 $200,000</td>
<td>---</td>
</tr>
<tr>
<td>2003</td>
<td>$100,000 $400,000</td>
<td>---</td>
</tr>
<tr>
<td>2004</td>
<td>$102,000 $410,000</td>
<td>---</td>
</tr>
<tr>
<td>2005</td>
<td>$105,000 $420,000</td>
<td>---</td>
</tr>
<tr>
<td>2006</td>
<td>$108,000 $430,000</td>
<td>---</td>
</tr>
<tr>
<td>2007</td>
<td>$125,000 $500,000</td>
<td>---</td>
</tr>
<tr>
<td>2008-2009</td>
<td>$250,000 $800,000</td>
<td>---</td>
</tr>
<tr>
<td>2010-2014</td>
<td>$500,000 $2,000,000</td>
<td>---</td>
</tr>
</tbody>
</table>

FIGURE II:
Immediate Expensing v. Tax Credit

<table>
<thead>
<tr>
<th></th>
<th>Immediate Expensing</th>
<th>Tax Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Cost of New Equipment</td>
<td>($50,000)</td>
<td>($50,000)</td>
</tr>
<tr>
<td>Immediate Expending</td>
<td>($2,000)</td>
<td>---</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$48,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Tentative Tax</td>
<td>$24,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>(50% flat tax rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Credit</td>
<td>---</td>
<td>($3,500)</td>
</tr>
<tr>
<td>(7% of cost of new equipment)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Due</td>
<td>$24,000</td>
<td>$21,500</td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td>24.0%</td>
<td>22%</td>
</tr>
</tbody>
</table>

The value of a tax credit to a corporation facing a hypothetical 50% tax rate is greater than the value of utilizing immediate expensing.\(^{304}\) The corporation is allowed to immediately expense 20% of the cost of the property maximum capped at $2,000.\(^{305}\) This brings the corporation


\(^{305}\) This was the original cap in 1958.
effective tax rate down from 50% to 24%. Alternatively, the corporation can enjoy 7% of the cost of the property as a tax credit, which brings its effective tax rate down from 50% to 22%. Although the immediate expensing rule only changed the timing of the depreciation deduction and not the amount of such deductions, the tax credit provided dollar-for-dollar reduction and had a larger effect on positive tax liability.  

**Figure III:**
Immediate Expensing v. Tax Credit with Low Net After-Tax Earnings

<table>
<thead>
<tr>
<th></th>
<th>Immediate Expensing</th>
<th>Tax Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits</td>
<td>$52,000</td>
<td>$52,000</td>
</tr>
<tr>
<td>Cost of New Equipment</td>
<td>$(50,000)</td>
<td>$(50,000)</td>
</tr>
<tr>
<td>Immediate Expending</td>
<td>$(2,000)</td>
<td>---</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$0</td>
<td>$2,000</td>
</tr>
<tr>
<td>Tentative Tax</td>
<td>---</td>
<td>$1,000</td>
</tr>
<tr>
<td>(50% flat tax rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Credit (7% of cost of new equipment)</td>
<td>---</td>
<td>$(3,500)</td>
</tr>
<tr>
<td>Tax Due (7% of cost of new equipment)</td>
<td>$0</td>
<td>$0</td>
</tr>
</tbody>
</table>

Figure III demonstrates that a corporation with scarce profits that invests almost all of them in purchasing new equipment is indifferent to utilizing the tax credit or immediate expensing. In both cases, the corporation ends up with no tax liability. Both effective tax rates are 0%. Although both investment incentives can be carried forward, their postponed value was reduced because of the concept of time value of money and the desirability to recover cost for income tax purposes at the earliest possible moment.

**Figure IV**
Investment Tax Credit 1962-1986

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>7%</td>
<td>Suspended Oct. 10, 1966-March 9, 1967&lt;sup&gt;307&lt;/sup&gt;</td>
</tr>
<tr>
<td>1967</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>Repealed</td>
<td>Effective April 21, 1969&lt;sup&gt;308&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>--</td>
</tr>
<tr>
<td>1971</td>
<td>7%</td>
</tr>
<tr>
<td>1972</td>
<td>7%</td>
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<tr>
<td>1973</td>
<td>7%</td>
</tr>
<tr>
<td>1974</td>
<td>7%</td>
</tr>
<tr>
<td>1975</td>
<td>10%</td>
</tr>
<tr>
<td>1976</td>
<td>10%</td>
</tr>
<tr>
<td>1977</td>
<td>10%</td>
</tr>
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<td>1978</td>
<td>10%</td>
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<td>1979</td>
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<td>1980</td>
<td>10%</td>
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<td>1981</td>
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<td>1982</td>
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<td>10%</td>
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<tr>
<td>1985</td>
<td>10%</td>
</tr>
<tr>
<td>1986</td>
<td>Repealed</td>
</tr>
</tbody>
</table>

Reinstated June 23, 1971<sup>309</sup>  
Effective Jan. 21, 1975<sup>310</sup>  
Effective Jan. 1, 1986<sup>311</sup>

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<sup>311</sup> Tax Reform Act of 1986 (TRA) (Pub.L. 99–514, 100 Stat. 2085, 2166 (enacted October 22, 1986)).
Figure VI: