

Expensing for Manufacturers

The Tax Cuts and Jobs Act (TCJA) improved the tax code's treatment of business investment, chiefly by enacting temporary bonus depreciation and reducing the corporate income tax rate from 35 percent to 21 percent. One hundred percent bonus depreciation would have been the most pro-growth element of the TCJA had it been permanent. That's because, compared to other tax cuts, 100 percent bonus depreciation leads to more investment per dollar of forgone tax revenue.¹ However, due to the temporary nature of bonus depreciation, the economic benefit to manufacturers is falling.

How Does Expensing Help Manufacturers?

Allowing businesses to deduct investments fully and immediately lowers the cost of capital and provides immediate access to cash. The TCJA permitted a 100 percent bonus depreciation deduction for short-lived assets with useful lives of 20 years or less through 2022. This allowed businesses to fully deduct investments in equipment, off-the-shelf software, non-luxury business vehicles, office furniture, and other productivity-enhancing assets in the year of purchase. The TCJA also allowed bonus depreciation for used equipment, a new provision. Bonus depreciation, however, began dropping by 20 percentage points per year starting in 2023 and will fully phase out by the end of 2026.

The Tax Foundation finds that bonus depreciation resulted in a 7.6 percentage point improvement in the ability of all businesses to deduct the real value

Quick Facts

Bonus depreciation has often been temporary. Since 2001, the percentage of short-lived investment that can be immediately deducted has frequently fluctuated. Fifty percent bonus depreciation was enacted in 2003 (up from 30 percent) for three years and was temporarily reintroduced from 2008 to 2010 in several different stimulus packages. In late 2010, 100 percent bonus depreciation was introduced for the remainder of 2010 and 2011. From 2012 to 2017, 50 percent bonus depreciation was temporarily extended several times. Establishing 100 percent bonus depreciation for five years in the TCJA, while temporary, provided more stability than the status quo, but left a permanent increase in investment, and the resulting benefits for manufacturers and the US economy, unrealized.

of their investments and improved cost recovery for manufacturing investment by 8.6 percent. Bonus depreciation allows manufacturers to recover the full cost of their investment in real terms, preventing inflation and the time value of money from eroding the value of their deductions.

In contrast, the TCJA required amortization of research and development (R&D) expenses. As a result, businesses cannot deduct the full value of

¹ <https://www.nber.org/papers/w32672>

their R&D investments, leading to less of it. R&D amortization also creates liquidity problems for small businesses; by forcing firms to spread out deductions over several years, R&D amortization taxes income that does not exist. Further, research from the Small Business Administration finds that small businesses benefit much more from R&D expensing than the R&D credit.²

The current tax treatment of R&D expenses and worsening treatment of short-lived assets is irrational, complicated, and counterproductive. Policymakers should let companies fully write off R&D and capital expenses immediately.

What Does This Mean for Workers?

Studies show that when bonus depreciation is available, businesses respond by investing in more equipment and increasing employment, as they need more workers to operate the new equipment. Increased capital investment and increased employment opportunities go hand in hand, as capital and production workers are complements in mod-

Economic Effects of Permanence for TCJA 100% Bonus Depreciation and R&D Expensing

Gross Domestic Product	0.50%
Gross National Product	0.40%
Capital Stock	0.90%
Full-time Equivalent Jobs	+106k
Wage Rate	0.40%

Source: Tax Foundation General Equilibrium Model, September 2024.

ern manufacturing. In the longer run, improvements in technology and efficiency can also lead to increased productivity and worker wages.

How Much Would Permanent TCJA Policies Cost?

Permanently restoring 100 percent bonus depreciation and R&D expensing would increase economic output by 0.5 percent, the capital stock by 0.9 percent, wages by 0.4 percent, and employment by 106,000 full-time equivalent jobs. Permanent bonus depreciation drives the results, increasing GDP by 0.4 percent and employment by 87,000 full-time equivalent jobs.

On a conventional basis, federal revenue would fall by \$609 billion over the 10-year budget window from 2025 through 2034 due to 100 percent bonus depreciation and R&D expensing permanence. On a dynamic basis, the 10-year revenue loss falls to \$372 billion.

The TCJA's lower corporate tax rate and temporary 100 percent bonus depreciation for short-lived assets reduced the cost of capital. This led to increased investment and a larger capital stock. Increased capital makes workers more productive and increases demand for workers, leading to both higher overall output and higher wages for workers. Policymakers can achieve growth in the manufacturing sector by making full expensing of capital investment and R&D a permanent feature of the tax code.

*Tyler Parks, Manager of Government Relations,
parks@taxfoundation.org*

*Paige Hanson, Senior Fellow,
phanson@taxfoundation.org*