DON'T MAKE TAX SHELTERS GREAT AGAIN: "PERMANENT EXPENSING" SHOULD NOT BE IN NEW COVID LEGISLATION

Big companies and their allies in Congress are trying to exploit the coronavirus crisis by including in the next COVID relief legislation two huge business tax cuts that could cost several hundred billion dollars in lost revenue. Known collectively as "permanent expensing" or "full expensing," the tax breaks would extend the ability of corporations to immediately deduct the full cost of major purchases and long-term research projects, rather than write them both off slowly, which better reflects those investments' gradual loss of value and ongoing benefits.

The 2017 Trump-GOP tax law temporarily allowed companies to deduct immediately ("expense") major purchases—like vehicles and machinery—and continue expensing investments in research and experimentation (R&E). Both allowances are scheduled to expire at the end of 2022, but the business lobby and some Congressional leaders now want to extend them indefinitely. Permanent expensing of R&E costs has been offered as a bill in the House of Representatives (H.R. 4549).

Expensing lowers reported income and therefore taxes in the year the money is spent, delaying those taxes until later. Based on pre-pandemic estimates, permanently extending the expensing of major purchases would cost some $200 billion in lost revenue. Permanently extending the right to expense R&E investments could cost hundreds of billions more.

Permanent expensing is a bad idea because it would:

- Be one more huge tax cut for big businesses that have already gotten a lot of them in recent years. First, the 2017 Trump-GOP tax law cut the corporate tax rate by 40%. It also gave the owners of noncorporate businesses a similar break that overwhelmingly went to the wealthiest—a 20% deduction on pass-through business income for an effective top tax rate of about 29% (down from 37%). Then the first CARES Act gave those same wealthy noncorporate business owners, especially real estate firms and hedge funds, the lion's share of a $135 billion tax break from leveraging business losses into tax savings.
- Not take effect until 2023, making whatever stimulative benefit it is supposed to provide unavailable in the worst years of the current recession.
- Invite the creation of tax shelters that benefit businesses and their wealthy owners, unless combined with the elimination of business interest deductibility (see below).

The drafters of the 2017 tax cuts mandated an end to expensing to contain the law's cost. Limited by strict budget rules in how much could be added to the national debt, big businesses and trade associations in negotiations leading up to the tax overhaul traded permanent expensing for a deep cut in the corporate tax rate and a similar break for noncorporate businesses. Big business is now reneging on the deal by greedily grabbing for permanent expensing in addition to the other favors they already gained in the law.

The push for permanent expensing in new COVID legislation continues a trend of corporations and business owners looking to exploit the coronavirus crisis as a way to water down the few business-related revenue raisers in the Trump-GOP tax law. The most glaring of these efforts—already successful—is the $135 billion "Millionaires Giveaway," which would change net operating loss rules and give 43,000 millionaires a tax cut this year worth on average $1.6 million each. Permanent expensing would be another expensive outrage entirely unrelated to the current emergency, particularly because it would not kick in until 2023.

WHY PERMANENT EXPENSING IS A BAD IDEA

- **It will drain away a lot of tax revenue needed to fight coronavirus and for other vital public services.** Pre-pandemic, the Congressional Budget Office (CBO) estimated that making permanent the expensing of big business purchases would cost $174 billion over seven years (p. 108, see "bonus depreciation"). The rate of revenue loss anticipated by that estimate implies the tax break would almost surely cost more than $200 billion over 10 years, the standard length of budget forecasts. Separately, back in 2016 when expensing of R&E investments was allowed as it temporarily still is now, CBO predicted that forbidding the practice would raise about $185 billion over 10 years. Revenue gained by closing a loophole is not always identical to what's lost by opening it—and the economy is now entirely transformed from four years ago—but it's still clear that permanently allowing the expensing of experimentation costs would cost a lot of money.

- **It would only come into effect in 2023, too late to provide help (if in fact it offers any, see below) in the worst years of the pandemic recession.** Rather than an economic stimulus for the economy, permanent expensing would just be a costly tax cut for big businesses that incentivizes businesses to buy equipment about three years from now. It might even deepen the recession, since if expensing is no longer going away, businesses will be in no rush to make the kind of big purchases or investments in research that tend to boost the economy and will be sorely needed in the next few years.

- **It does not raise wages and can lead to long-term job losses through automation.** A recent academic study found that wages don't rise when companies can expense big purchases, probably because employee bargaining power declines as businesses use more generous depreciation rules to invest in machines to replace workers.

- **It is far from clear that permanent expensing encourages business investment.** Evidence suggests that expensing may not change the analysis that businesses make before investing and that its financial effect on businesses depends on other factors. So while this loophole will cost the government a lot of lost revenue it may not do much for businesses' bottom lines or their appetite to invest.

- **Only bigger companies would benefit, since small businesses already enjoy permanent expensing.** Current law already permanently allows expensing for purchases of up to around $1 million by businesses whose total big-item purchases don't exceed $2.6 million in a year (and allows some expensing for companies that spend up to $3.6 million). Since those limits—which increase with inflation—easily accommodate small and even medium-

sized businesses, big firms would be the only beneficiaries of the current drive to make expensing permanent for purchases of all sizes.

- **Permanent expensing allows companies to make money off bad investments.** It encourages the creation of "tax shelters." In situations where businesses finance purchases with debt, the combination of full expensing and partial deduction of interest on the debt enables those businesses to get more back from the IRS than they invested. This gaming of the tax system does nothing to help the economy grow.

- **Full expensing put in place under the Trump-GOP tax cuts let corporations dodge billions of dollars in taxes in 2018, according to the Institute on Taxation and Economic Policy.**
  - General Motors made $4.3 billion in profits in 2018 but got a federal income tax refund; it saved $680 million in taxes because of full expensing.
  - Target made $2.8 billion in profits in 2018 and paid just $257 million in federal income taxes—a 9.1% tax rate. It saved $293 million in taxes from full expensing.
  - IBM reduced its federal taxes by $140 million in 2018 due to full expensing. The company made $500 million in profits but got a federal tax refund of $342 million.

IF CONGRESS ENACTS PERMANENT EXPENSING, IT SHOULD END INTEREST DEDUCTIONS

If Congress accedes to the demands of corporate interests and enacts permanent expensing of large purchases, it should eliminate the deduction for interest on business debt, which, when combined with expensing, can turn tax bills into fat refunds. That's because if a business buys a big-ticket item on credit and can both immediately deduct the full cost of the purchase and deduct interest payments on the loan, it can create "negative" tax liability on the transaction: instead of paying taxes, getting money back. As the Wall Street Journal has noted, this would be a big boost to debt-laden real estate firms like The Trump Organization.

Congress recognized the potential for this kind of lucrative gaming of the system in the 2017 tax law, which limited how much interest businesses could deduct to 30% of adjusted taxable income at the same time it allowed for temporary expensing. While that provision raised $253 billion over 10 years, it didn't go far enough and created an opportunity for gaming. If expensing of big-ticket purchases is made permanent, good tax policy demands that the interest deduction be entirely eliminated.