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Business Tax Provisions in The Tax Relief for American Families and Workers Act of 2024

The Tax Relief for American Families and Workers Act of 2024, released by the Senate Finance Committee on January 16, 2024, and introduced in the House (H.R. 7024) would, among other provisions, modify four business tax provisions enacted in P.L. 115-97, referred to as the Tax Cuts and Jobs Act of 2017 (TCJA). Temporary provisions include extending first-year expensing, reinstating expensing for research expenses, and reinstating a broader definition for income for purposes of the limit on interest deductions. The proposal would also increase the dollar limit of first-year depreciation aimed at smaller businesses, a permanent provision.

Extension of First-Year Expensing of Equipment ("Bonus Depreciation")

The proposal would retroactively extend first-year expensing, commonly referred to as bonus depreciation, for assets placed in service after December 31, 2021, through 2025.

The cost of assets that provide services over a period of time, such as machines or buildings, is deducted over a period of years as depreciation. The schedule of depreciation deductions depends on the asset's life and the distribution of deductions over that life. Straight-line depreciation is used for structures, where equal amounts are deducted in each year. For equipment, deductions are accelerated, with larger amounts deducted in earlier years. Equipment is most commonly depreciated over 5 or 7 years, but some short-lived assets are depreciated over 3 years and some longer-lived assets are depreciated over 10, 15, or 20 years. Residential structures are depreciated over 27.5 years and nonresidential structures are depreciated over 39 years. Aside from the desire for economic stimulus, traditional economic theories suggest that tax depreciation should match economic (physical) depreciation of assets as closely as possible.

The expensing provision enacted in 2017 allows immediate deductions for depreciation, which are valuable because of the time value of money. A fixed reduction in tax liability today is worth more than that same fixed reduction in tax liability in the future. Expensing provisions allow a firm to deduct the cost of an asset the year it is placed in service. Expensing or partial expensing is also commonly referred to as bonus depreciation. The expensing provision does not apply to structures.

The TCJA allowed full (100%) expensing of investments in qualifying equipment and property through 2022. The share of investments that can be deducted in the year they are incurred is scheduled to decrease to 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026, and 0% for property acquired and placed in service in 2027 and thereafter.

Full expensing leads to an effective zero tax rate on new tangible business investment financed with only equity, and to negative tax rates when financed in part by borrowing. The regular depreciation rules are accelerated (relative to economic depreciation) and also confer a benefit that is estimated to result in a 13.7% tax rate for equity-financed corporate investment, below the 21% statutory rate. For more on effective tax rates, see CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

Incentives for equipment investment favor those investments relative to investment in buildings, although they lead to uniform treatment with respect to investment in most intangibles which are currently expensed (such as advertising to create brand identification, workforce development, and, until 2022, research expenses).

See CRS Report RL31852, *The Section 179 and Section 168(k) Expensing Allowances: Current Law, Economic Effects, and Selected Policy Issues*, by Gary Guenther for further discussion.

Reinstatement of Expensing of Research and Experimentation Expenditures

The proposal would reinstate expensing of research and experimentation (R&E) expenditures for 2022-2025.

Investments in research and development (such as the cost of labor and supplies) have traditionally been expensed (immediately deducted), although these investments create assets that yield income in the future. The TCJA provided that, beginning in 2022, domestic costs would be deducted in equal amounts over five years (i.e., five-year amortization). Foreign costs are subject to 15-year amortization. This treatment does not apply to equipment and structures used for research and development, which are recovered using regular depreciation rules.

Research expenditures are also eligible for a tax credit, and the amount of expenditures is reduced by the credit for both expensing and five-year amortization. These features together lead to significant negative effective tax rates under either expensing or five-year amortization, largely due to the credit. For effective tax rates, see CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

Some argue evidence suggests that there is underinvestment in research because the social benefits of the assets exceed the private benefits. That is, companies cannot fully capture the earnings from investments in research. Both expensing and the R&E credit, they argue, are often justified on this basis. For a discussion of this evidence, see CRS Report RL31181, *Federal Research Tax Credit: Current Law and Policy Issues*, by Gary Guenther.

Reinstatement of the Earnings Before Taxes, Interest, Depreciation, and Amortization (EBITDA) for Determining the Interest Deduction Limit

The Tax Relief for American Families and Workers Act of 2024 would temporarily reinstate EBITDA as the basis for the 30% limit on interest deducted as a share of income for 2022 through 2025.

Prior to the TCJA, the deduction for net interest was limited to 50% of adjusted taxable income for firms with a debt-equity ratio above 1.5. (Adjusted taxable income is income before taxes, interest deductions, and depreciation, amortization, or depletion deductions.) Interest above the limitation could be carried forward indefinitely. The law limited deductible interest to 30% of adjusted taxable income for businesses with gross receipts greater than $25 million. The provision also had an exception for floor plan financing for motor vehicles. Businesses providing services as an employee and certain regulated utilities are excepted from this new limit. Also, certain real property and farming businesses can elect out of this limit but must adopt a slower depreciation method for real property or farming assets.

Under prior law and the temporary provisions of the TCJA, this interest limit applies to earnings (income) before interest, taxes, depreciation, amortization, or depletion (referred to as EBITDA). After 2021, the TCJA changed the measure of income to earnings (income) before interest and taxes (referred to as EBIT). Because EBIT is after the deduction of depreciation, amortization, and depletion, it results in a smaller base and thus a smaller amount of eligible interest deductions. The temporary broader base (EBITDA), which expired in 2021, allowed more interest deductions. The more generous rules for measuring the adjusted taxable income base are more beneficial to businesses with depreciable assets, although affected businesses might be able to avoid some of the change in the deduction rules by leasing assets from financial institutions, such as banks, that generally have interest income.

The restrictions on interest, called thin capitalization rules, were partially enacted to address concerns about large multinational businesses locating borrowing in the United States as a method to shift profits out of the United States and to foreign, lower-tax jurisdictions. See CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples, for a discussion.

In addition, debt-financed investments are favored by the tax law because nominal interest is deducted (i.e., the gains from repaying debt in cheaper dollars are not recognized), while most interest is not taxed to the lender. For estimates of total effective tax rates with full or partial debt finance, see CRS Report RL34229, *Corporate Tax Reform: Issues for Congress*, by Jane G. Gravelle. This favoritism may be offered as a reason for limiting interest deductions.

First-Year Depreciation Dollar Limits (Section 179 Expensing)

This provision permanently raises the dollar limits on the amount of investment that can be expensed.

Regardless of the general rules on depreciation, a provision allows expensing of equipment up to a specified dollar amount, a provision aimed at smaller businesses. The TCJA raised that limit to $1 million, with the expensing phased out dollar for dollar after investment of $2.5 million. Those provisions were indexed for inflation and were $1.16 million and $2.9 million in 2023. The proposal would raise these limits to $1.29 million and $3.22 million in 2024, respectively, and index them for inflation. Because of the extension of expensing, this change is not that relevant until 2026.

The expensing for smaller businesses is sometimes done as a simplification measure and sometimes to encourage investment for small businesses. However, it also could discourage investment in the phaseout stage.

See CRS Report RL31852, *The Section 179 and Section 168(k) Expensing Allowances: Current Law, Economic Effects, and Selected Policy Issues*, by Gary Guenther for further discussion.

Revenue Costs

The Joint Committee on Taxation estimates that the total cost for these provisions is $32.8 billion over 10 years (FY2024-FY2033). Temporary expensing for depreciation and R&D would have their initial losses ($68.3 billion and $96.6 billion in the first two years) largely offset by future gains because these provisions are timing shifts, with 10-year estimates at $3.0 billion for bonus depreciation and $8.5 billion for R&D. There would nevertheless be a cost to the government in increased interest payments to allow the deferral of revenues. The move from EBITDA to EBIT has a 10-year cost of $18.8 billion for FY2024 through FY2033, with most of the cost ($16.4 billion) in the first two years. The increase in the dollar limit for Section 179 expensing is estimated at $2.5 billion over 10 years.

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