



Expensing of Capital Assets is Important for Tax Simplification and U.S. Competitiveness

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When I was head of the tax department at Advanced Micro Devices, I was constantly reminded by the chief financial officer that cash flow was everything to a capital intensive business. To generate more cash flow, I would attempt to reduce taxes by every legal means, including deferring revenues and making sure we used the fastest depreciation methods available. Component depreciation studies helped in the analysis of possible greater tax deductions for new plants and equipment.

It is not uncommon for a new, state-of-the-art semiconductor plant to cost today between two-three billion dollars. To be able to afford this size plant, tax considerations are an important part in the overall planning mix. Many foreign countries permit asset expensing or grant generous tax holidays for new plants. In an attempt to help the U.S. become a more competitive location, the Semiconductor Industry Association has been one of the leaders in pursuing shorter depreciation periods under U.S. law. In a major study in the early 1990s, a government/industry panel recommended that semiconductor depreciation lives be reduced from five years to three years, with the result, according to the study, that investment would increase by 11% a year and more U.S. jobs would be created in the industry.

Congress has only occasionally been interested in the depreciation area. The Tax Reform Act of 1986 addressed many depreciation issues. However, industry has not been totally in sync with the depreciation lives in this Act, especially with regard to the high-tech arena where depreciation periods for computers and semiconductors arguably are too long at five years. Along with Ernie Christian, I joined a depreciation expensing initiative (Cost Recovery Action Group-CRAG) in 2000. Its goal was to expense high-tech equipment in all industries and reduce depreciable lives by one category (e.g., from 10 years to 7 years). Many industries joined this effort, including semiconductors, semiconductor equipment, steel, paper, publishers and machine tools. The CRAG initiative had a responsive audience in the Congress and helped to bring 30% and 50% bonus depreciation to these industries in the years 2002-2004. This relief helped pull the economy out of a recession and made U.S. asset purchases more competitive with many foreign competitor country laws.

While you would think most companies would support expensing initiatives, for a variety of reasons some chose not to support the effort. Some companies said they were not capital intensive. Other capital intensive companies said they had net operating losses and could not absorb faster depreciation. In fact, a couple of companies were so mired in losses that they were doing everything they could to slow down depreciation to help prevent the expiration of the depreciation deductions generated over a 15 year (now 20 year) carryover window. Some in the capital intensive group who could use the faster depreciation chose not to actively support the initiative. Their rationale was that depreciation is just a

timing issue relating to what year the deduction will be taken and does not offer the type of permanent tax relief that a credit (such as a research and experimental credit) would offer.

Nonetheless, expensing still has sizeable support among the corporate community and one strange bedfellow-the Internal Revenue Service. Having just completed a four-year U.S. Treasury Department appointment to the Large and Mid-Size Business Division of the IRS, I can tell you that many in the IRS would like to be done with depreciation issues. The IRS wants to put its resources into more productive tax-generating areas. This new IRS thinking is manifesting itself through a variety of corporate taxpayer audit initiatives, such as the Limited Issue Focused Exam (LIFE) program where the IRS is instructing its agents to ignore immaterial timing issues from depreciation (e.g., moving an item from one year to the next) and to focus on permanent tax saving issues, such as the Research and Experimental Tax Credit.

Many members of the Congress would also like to simplify depreciation rules. Ways and Means Committee member Jerry Weller (R-Ill.) has introduced H.R. 2319, which allows permanent full expensing and H.R. 2320, which allows permanent 50-percent expensing. Ways and Means Committee Congressman Phil English (R-PA.) has in the past introduced expensing bills for high-productivity equipment. Senate Finance Committee member Gordon Smith (R-OR) has introduced S. 1632, which allows temporary 30-percent expensing. Most recently, the President's Advisory Panel on Tax Reform recommended expensing of capital assets as part of its agenda to simplify tax administration and make U.S. companies more competitive.

CRAG members plan to continue legislative efforts for the expensing of capital assets. Expensing will aid in tax simplification and in a reduction of record-keeping and IRS audit time. Such expensing will also help U.S. companies be more competitive with their overseas competitors.