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# CRS Report for Congress

# Tax Provisions of the Economic Stimulus Package

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## Summary

The economic stimulus package, P. L. 110-185, contained two major components: individual tax rebates costing an estimated $117 billion in FY2008 and FY2009, and depreciation provisions (bonus depreciation and small business expensing costing an estimated $46.3 billion. This report describes the stimulus package's major components and their likely impacts as an economic stimulus.

In February 2008, the Congress passed H.R. 5140, the economic stimulus package, which was signed into law as P. L. 110-185. The most important part of the proposal was the individual income tax rebate, which accounted for around $117 billion of the packages's estimated cost in FY2008-FY2009. The proposal also included two provisions for businesses that allowed a speed-up in depreciation, which is expected to cost $51 billion in the first two fiscal years. Because these business provisions shifted deductions into the present from the future, they eventually result in revenue gains and a much smaller overall cost in the 10-year budget horizon. These costs are shown in **Table 1**.

## Individual Tax Rebates

The centerpiece of the stimulus package is the tax rebate for individuals. Unlike the 2001 rebate, the rebates have elements of refundability: families with no tax liability may also be eligible for a rebate.

**Table 2** lists the specifics of the provision. The rebate is technically a credit for 2008, but payments would be mailed in 2008 based on 2007 returns. If taxpayers qualify for a higher credit based on their 2008 circumstances, they could claim the excess on their 2008 returns. Essentially, the rebate allows the larger of those based on either 2007 or 2008 circumstances.

## Table 1. Estimated Budgetary Cost of P. L. 110-185

(billions of dollars)

| Provision | FY2008 | FY2009 | FY2008-2018 |
|---|---|---|---|
| Rebates for Individuals | -106.7 | -10.0 | -116.7 |
| Appropriations to Carry Out Rebates | -0.2 | -0.1 | -0.3 |
| Increase Sec. 179 Expensing and Phaseout Amounts for 2008 | -0.9 | -0.6 | -0.1 |
| 50% Bonus Depreciation | -43.9 | -5.6 | -7.4 |
| **Total** | **-151.7** | **-16.3** | **-124.5** |

**Source:** Joint Committee on Taxation, JCX-17-08, February 8, 2008.

## Table 2. Provisions of the Rebate

| Provision | Details |
|---|---|
| General Rebate Proposal | 10% of the first $6,000 of taxable income ($12,000 for couples), to extent of tax liability; maximum $600/$1,200, minimum $300/$600. |
| Refundability Provisions | $300 rebate ($600 for couples) available for those without tax liability if earned income plus Social Security benefits, tier 1 railroad retirement, and veteran's disability payments are at least $3,000.* |
| High-Income Phaseout | Phased out at 5% of income over $75,000 for single individuals, $150,000 for couples. Payment fully phased out at $87,000 for singles and $174,000 for individuals. |
| Child Provisions | $300 per qualifying child if eligible for any other rebate. Eligibility criteria are the same as for the child credit. |
| Other Features | Disallows the rebate to illegal immigrants by requiring a social security number. |

*Note: Eligible income does not include SSI or pensions including government and military pensions (including disability), or any unearned income including withdrawals from IRAs. It is limited to Social Security payments (old age, survivors and disability), tier 1 railroad retirement, and veterans disability payments under titles 11, 13 and 15 of Chapter 38 of the U.S. Code.

**Source:** Congressional Research Service.

There are five elements of the rebate proposals that are outlined in **Table 2**. The first is the basic nature of the rebate, which is 10% of income up to a maximum, with a minimum payment. The second element is the refundability feature, which extends benefits to lower income households without tax liability. The third element is the treatment of high-income taxpayers whose payments are phased out. The fourth element is the child rebate, which in all plans is set at $300 per qualifying child and allowed if a basic or refundable rebate is received. The fifth element limits the scope of the rebates by denying them to illegal immigrants through requiring the taxpayer identification number to be a social security number.

Compared to the experience with a rebate in 2001, the proposed rebates are more favorable to lower income individuals because of their refundability provisions. While the administration originally proposed a package with no refundability, the House allowed a minimum payment for low-income earners with at least $3,000 of income. The Senate extended the rebate to lower income retirees (social security, railroad retirement, and veteran's disability) and this extension was adopted. Both changes expanded the number of taxpayers affected. Without any refundability provisions, 37% of 151 million returns, or 56 million would have been excluded because of low incomes or lack of tax liability. Adding low-income earners as in the House bill excluded only 30 million because of low incomes, that is, made an additional 26 million eligible. Adding retirees meant only 10 million were excluded. Thus the refundability feature added 46 million taxpayers: 26 million due to the earnings rule and 20 million due to the retirees rule. (The stimulus also excludes about 9 million because of high incomes.) [1] The original House bill was more progressive (i.e., relatively more favorable to lower income households) than a non-refundable rebate. The final law is more progressive than the House bill.

Although some rebates in the past appeared to be relatively ineffective in increasing spending, there is some evidence that the 2001 rebate was spent.[2] In general, economic analysis suggests that benefits that go more heavily to low-income individuals are likely to be more effective at stimulating the economy in the short term, per dollar of payment, than those with smaller benefits because lower income households are more likely to spend the rebate, and spending is necessary to produce a stimulus. The extension of rebates to those with Social Security payments could be quite complex administratively, since it would require filing and processing up to an additional 18 million tax returns.[3] (The IRS has announced a simplified tax return filing for these households, using the 1040A tax form.)

## Business Tax Incentives

The bill includes two business provisions aimed at stimulating investment. The first was bonus depreciation, allowing 50% of investment with a life of less than 20 years (which applies mostly to equipment) to be deducted when purchased. The second addressed a provision that allowed small businesses to deduct all equipment investment when purchased, by increasing the ceiling on eligible equipment and phasing out the benefit more slowly. These provisions are shown in **Table 3**.

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[1] For a more detailed analysis of the refundability provisions, see CRS Report RL34341, *Tax Rebate Refundability: Effects and Issues*, by Jane G. Gravelle.

[2] See CRS Report RS22790, *Tax Cuts for Short-Run Economic Stimulus: Recent Experiences*, by Jane G. Gravelle.

[3] According to the Tax Policy Center, 18 million households over the age of 65 would receive no rebate under the House bill. See Tax Policy Center, Table T08-0030, at [http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=1742&DocTypeID=4].

## Table 3. Business Tax Provisions

| Provision | Details |
|---|---|
| Bonus Depreciation | For 2008, allows 50% of eligible investment (generally equipment) to be deducted when incurred. |
| Small Business Expensing | For 2008, increases the amount of eligible investment (generally equipment) expensing from $128,000 to $250,000; begin phaseout at $800,000 instead of $510,000. Phaseout completed at $1,050,000. |

**Source:** Congressional Research Service.

The bonus depreciation provisions are the most costly of the business provisions, amounting to an estimated $43.9 billion in FY2008 and $5.6 billion in FY2009. As with all of the provisions, which largely involve timing, revenue is gained in future years as regular depreciation deductions fall. Over 10 years, the cost is $7.4 billion, as shown in **Table 1.** The small business expensing provision costs an estimated $0.9 billion in FY2008 and $0.6 billion in FY2009, with the 10-year cost $0.1 billion.

Because these benefits arise from timing, neither the initial cost nor the 10-year cost provide a good reflection of the value to the firm. For the benefit of bonus depreciation to the firm, the discounted values (using an 8% nominal interest rate) would be about $18 billion.

Based on empirical evidence, it is unlikely that these provisions would provide significant short-term stimulus. Investment incentives are attractive, if they work, because increasing investment does not trade off short-term stimulus benefits for a reduction in capital formation, as do provisions stimulating consumption. Nevertheless, most evidence does not suggest these provisions work very well to induce short-term spending.[4] This lack of effectiveness may occur because of planning lags or because stimulus is generally provided during economic slowdowns when excess capacity may already exist.

Of business tax provisions, investment subsidies are more effective than rate cuts at providing a short-term stimulus, but there is little evidence to support much stimulus effect. Temporary bonus depreciation is likely to be most effective in stimulating investment, more effective than a much costlier permanent investment incentive because it encourages the speed-up of investment. Although there is some dispute, most evidence on bonus depreciation enacted in 2002 nevertheless suggests that it had little effect in stimulating investment and that even if the effects were pronounced, the benefit was too small to have an appreciable effect on the economy.

Based on theoretical considerations, the likelihood of the expensing provision having much of an incentive effect is even smaller. Firms may, for example, benefit from the small business expensing, but it actually discourages investment in the (expanded) phase out range.

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[4] See CRS Report RL31134, *Using Business Tax Cuts to Stimulate the Economy*, and CRS Report RS22970, *Tax Cuts for Short Run Economic Stimulus: Recent Experiences*, by Jane G. Gravelle.