COST RECOVERY REFORM AND SIMPLIFICATION DISCUSSION DRAFT

The discussion draft would radically simplify one of the most complex areas of today's tax code and remove current barriers to businesses reinvesting in machinery and equipment on a revenue neutral basis, while maintaining accelerated depreciation.

Today, there are $40 trillion in productive capital assets in the U.S. economy, with $2.5 trillion added every year. This includes everything from heavy machinery and manufacturing equipment, to computers and medical equipment. While capital investment is one of the key drivers of growth in our economy, the tax code imposes costs and complexity every time a business buys or sells a piece of equipment. In addition, the Congressional Budget Office (CBO) finds that today's cost recovery rules are one of the main drivers of bias between taxation of investments in different industries. This legislation would replace our current cost recovery system with a radically simplified Accelerated Mass Asset Cost Recovery and Reinvestment System (A-MACRRS) which would do the following:

Replace more than 100 complex depreciation schedules with six "pools," while maintaining accelerated depreciation. Current depreciation rules require businesses to depreciate assets in a variety of ways. For example, normal depreciation may be calculated as many as six different ways, and a taxpayer may be required to compute depreciation on the same asset under three separate methods every year to determine its Alternative Minimum Tax and Earnings & Profits. In addition, taxpayers are required to calculate depreciation on every single asset, every year—meaning thousands or even millions of calculations for some businesses. This legislation would combine machinery and equipment into six pools based on current accelerated depreciation schedules, and allow taxpayers to compute depreciation with only six calculations for their entire business under a single method.

Significantly expand tax-free reinvestment rules. The tax code generally applies tax to the sale of used machinery and equipment, even if a taxpayer uses the proceeds to invest in new equipment. The tax code provides a narrow "like-kind" exception, where taxpayers may roll-over investments if they meet a set of strict criteria, including specific identification of assets, acquisition within a set period, and requiring the acquired asset remain in the same "asset class" as the relinquished asset. In addition, many taxpayers must establish escrow accounts and use "qualified intermediaries" to identify exchange assets and comply with the extreme complexity of these rules. This legislation would expand similar tax-free reinvestment benefits to all same-pool machinery and equipment, without the complex like-kind rules.

Repeal complex accounting rules and increase first-year depreciation deductions. Businesses must currently use complex half-year and mid-month accounting rules, which allow taxpayers only one-half the depreciation deduction otherwise available in an asset's first year in service. These rules limit first-year depreciation deductions, and contribute to complexity and uncertainty for businesses. This legislation would repeal the half-year and mid-month rules for machinery and equipment.

Remove unnecessary complexity, uncertainty, and bias. Today's depreciation rules were last updated nearly 30 years ago, before the advent of modern computing, and during a time when the U.S. economy was very different. According to the CBO, outdated depreciation lives are one of the main drivers of the tax code's bias between investments in different industries. For example, the CBO estimated the effective marginal tax rate on investments in computers and software is nearly 40%, while the rate on railroad track and mining structures is about 15%. These inequities not only disadvantage certain industries, but also hold back investment and act as a drag on our economy. This legislation would reinstate Treasury authority, subject to Congressional oversight, to update asset lives to account for new technologies and a modern economy. It would also reform and simplify a raft of related cost recovery and accounting rules to reduce uncertainty and unnecessary complexity.