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Article

Lessons in Cyclical Fiscal Activism

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This Article highlights an anomaly. It tells a story of two tax rules that were introduced at the same time to achieve a similar goal. Both were meant to be temporary and stimulate economic growth but received dramatically different outcomes. The Article reviews the reasons for this paradox. It demonstrates that the causes are structural, ideological, and political. It argues that the historical support the two mechanisms received diverged in accordance with their complexity, the perceptions they epitomized, and their instrumental role in society. The Article not only enriches an important and ongoing debate on the role of the tax system in our society that has received much attention in recent years, but also provides important historical insights to policymakers.

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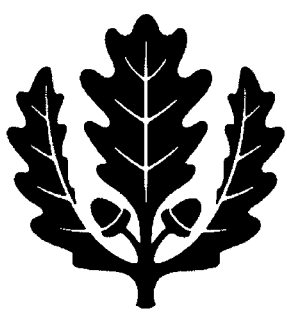

Lessons in Cyclical Fiscal Activism

MIRIT EYAL-COHEN*

I. INTRODUCTION

> One thing about businessmen—they condition more readily than any maze-running rats or the most impressionable of Pavlov's dogs. Give them a reward for increasing their investment in new plant and equipment—the 7 percent investment credit—and watch them run for it. Threaten to take it away, and watch them run even faster.
>
> —Albert L. Kraus, N.Y. Times, 1969[1]

In the last half-century, we have witnessed a massive expansion of government-provided incentives.[2] The use of tax preferences produces many advantages that increase the rate of return on cash flow from investments.[3] More recently, during reform debates, Representative Kevin Brady (R-TX) declared that extending tax incentives for investments would stimulate the economy and help close the "Growth Gap" between

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[1] Albert L. Kraus, *Investment Tax Credit: Possible Suspension Sparks Advance in Spending on Plant and Equipment*, N.Y. TIMES, Mar. 26, 1969, at 61.

[2] *See, e.g.*, J. Clifton Fleming, Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437, 561–62 (2008) (using tax expenditure analysis to identify various tax subsidies and incentives in the international tax arena that should be significantly modified or repealed); Tracy A. Kaye, *Taxation and Development Incentives in the United States*, 62 AM. J. COMP. L. SUPP. 617, 621 (2014) (comparing investment tax incentives in the United States and European Union); KAREN DYNAN ET AL., BROOKINGS INST., AN EVALUATION OF FEDERAL AND STATE HOMEBUYER TAX INCENTIVES 2 (2013), http://www.brookings.edu/~/media/research/files/papers/2013/06/28-homebuyer-tax-incentives-dynan-gayer/28_homebuyer_tax_incentives_dynan_gayer2.pdf [https://perma.cc/PMQ9-QS2Z] (examining the expansion of the various state and federal homebuyer tax credits and deductions).

[3] It allows taxpayers to recover their costs faster, lower the effective tax rate, and reduce the net cost of new investments. Theodore P. Seto, *The Problem with Bonus Depreciation*, 126 TAX NOTES 782, 784 (2010).

current and previous economic recoveries.[4] "The bottom line," he avowed, "is that faster growth in business investment generates faster private-sector job growth."[5] On the other hand, economic policy specialists continue to assert that the merits of tax benefits for capital investment or job creation are dubious.[6]

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[4] JOINT ECON. COMM., BONUS DEPRECIATION: CLOSING THE GROWTH GAP 1–4 (2014), http://www.jec.senate.gov/public/_cache/files/c83cbb43-402e-4a8b-ba36-2e2935b5e010/bonus-depreciation---closing-the-growth-gap.pdf [https://perma.cc/4JTR-PXGK].

[5] *Id.* at 1; *see also* Glenn Hubbard, *As the Fed Moves, It Needs a Road Map*, WALL ST. J., Jan. 4, 2016, at A13 ("After the depths of the financial crisis, the government has depended too much on the Fed to support economic activity. Fiscal policy could have reduced the cost of capital substantially through greater investment incentives and business-tax cuts. . . . Economic growth is vital, but it can't be achieved through monetary policy, certainly not by monetary policy alone."); *Is It Fair to Tax Capital Gains at Lower Rates than Earned Income?*, WALL ST. J., Mar. 2, 2015, at R4 ("Investment capital is one of the most important drivers of economic growth . . . ."); Robert J. Samuelson, *No Tooth Fairy on Taxes*, WASH. POST, Nov. 2, 2015, at A17 ("The effect of tax policies on economic growth is clearly important."); Andrew Lundeen, *Permanently Extending Bonus Depreciation Grows the Economy*, TAX FOUND. BLOG (May 27, 2014), http://taxfoundation.org/blog/permanently-extending-bonus-depreciation-grows-economy [https://perma.cc/H9LE-JQF3] (stating that in the absence of comprehensive tax reform, the next best option to create jobs, increase wages, and grow the economy is a permanent extension of bonus depreciation); William McBride, *The Economic and Budgetary Effects of Bonus Expensing*, TAX FOUND. (Apr. 29, 2014), http://taxfoundation.org/article/economic-and-budgetary-effects-bonus-expensing [https://perma.cc/Y4YB-68SV] (finding that extending 50% bonus expensing on a permanent basis would boost GDP by over 1%, the capital stock by over 3%, wages by about 1%, and would create 212,000 jobs); MOLLY F. SHERLOCK, CONG. RESEARCH SERV., TAX PROVISIONS THAT EXPIRED IN 2014 ("TAX EXTENDERS") 2–3 (2015), http://www.fas.org/sgp/crs/misc/R43898.pdf [https://perma.cc/R2SE-D2HP] (providing a broad overview of tax extenders). *But see* Ashlea Ebeling, *Depreciation Tax Extenders Big Bonus for Business Owners*, FORBES (Dec. 18, 2014), http://www.forbes.com/sites/ashleaebeling/2014/12/18/depreciation-tax-extenders-big-bonus-for-business-owners/ [http://web.archive.org/web/20160106022221/http://www.forbes.com/sites/ashleaebeling/2014/12/18/depreciation-tax-extenders-big-bonus-for-business-owners/] (asserting that bonus depreciation has been around so long that it seems like a "business gimme"); John D. McKinnon, *House Committee Approves Permanent Depreciation Tax Break; Proposal Allowing Businesses to Deduct 50% of Capital Purchases Up Front Heads to Full Senate*, WALL ST. J. (May 29, 2014), http://www.wsj.com/articles/house-committee-approves-permanent-depreciation-tax-break-1401388593 [http://web.archive.org/web/20150909092955/http://www.wsj.com/articles/house-committee-approves-permanent-depreciation-tax-break-1401388593]; Bill Smith, *Small Business Advice: Hurry, These Four Tax Breaks Expire at the End of the Year*, WASH. POST (Nov. 26, 2013), https://www.washingtonpost.com/business/on-small-business/small-business-advice-hurry-these-four-tax-breaks-expire-at-the-end-of-the-year/2013/11/25/a2fa85c0-5613-11e3-ba82-16ed03681809_story.html [https://perma.cc/Y29S-ST5V].

[6] *See* JANE G. GRAVELLE, CONG. RESEARCH SERV., BONUS DEPRECIATION: ECONOMIC AND BUDGETARY ISSUES 7 (2014), http://nationalaglawcenter.org/wp-content/uploads//assets/crs/R43432.pdf [https://perma.cc/AV8T-M5ZS] (concluding that tax incentives such as the bonus depreciation "did not appear to be very effective in providing short-term economic stimulus compared with alternatives"); Thomas Gryta, *AT&T, Verizon Tax Breaks Fail to Produce Jobs, Lower Bills Didn't Lead to Increased Investment or Employment*, WALL ST. J. (Dec. 11, 2014), http://www.wsj.com/articles/at-t-verizon-tax-breaks-fail-to-produce-jobs-1418345589 [http://web.archive.org/web/20160210002331/http://www.wsj.com/articles/at-t-verizon-tax-breaks-fail-to-produce-jobs-1418345589] ("Meanwhile, the companies have kept their capital spending relatively flat since the stimulus was adopted, and their employee count has dropped by more than 100,000 people, a fifth of their combined work forces. . . . AT&T and Verizon appear to be using the benefit as intended, and both are plowing

The immediate expensing rule is an example of a capital investment incentive. Under this rule, taxpayers benefit from deducting the cost of new purchases of capital assets instead of capitalizing it over their ordinary useful life.[7] The benefit phases out, dollar for dollar, when a taxpayer's cost surpasses a certain threshold.[8] Enacted as a *temporary* measure in the late 1950s, Congress has continually extended it to the present day. In fact, in his most recent revenue proposals, President Obama suggested greatly increasing and making this tax preference *permanent*.[9]

The immediate expensing rule is a tax preference that reflects a historical path dependency.[10] It is one of numerous tax benefits enacted in 1958 as part of far-reaching small business legislation in the hopes of creating jobs and boosting economic growth.[11] However, a closer look at the immediate expensing rule reveals that its coverage does not correspond to its content. *De facto*, the provision's language does not confine the benefit to small firms. Nevertheless, this measure has been termed, considered, and promoted as a small business tax benefit for political reasons. In fact, although immediate expensing's label has remained unchanged, in recent years its declared policy removed the focus on small

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tens of billions of dollars into their networks."); *see also* CHUCK MARR & BRANDON DEBOT, CTR. ON BUDGET & POLICY PRIORITIES, HOUSE EFFORTS TO MAKE TAX "EXTENDERS" PERMANENT ARE ILL-ADVISED 4 (2015), http://www.cbpp.org/files/5-7-14tax.pdf [https://perma.cc/ULY3-N384] (noting that adding bonus depreciation to the extenders provisions would raise the cost to more than four-fifths of the total "fiscal cliff" savings).

[7] Under § 179 of the Internal Revenue Code ("Code"), the dollar limitation on such immediate expensing was $250,000 in the case of taxable years beginning after 2007 and before 2010, $500,000 in the case of taxable years 2010–2014, and $25,000 in the case of taxable years beginning after 2014. Tax Increase Prevention Act of 2014, H.R. 5771, 113th Cong. (2014).

[8] I.R.C. § 179(c) (2012); Tax Increase Prevention Act of 2014, Pub. L. No. 113-29, § 127(a)(1), 128 Stat. 4010, 4017.

[9] I.R.C. § 179; *see also* DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS 21 (2014), http://www.treasury.gov/resource-center/tax-policy/documents/general-explanations-fy2015.pdf [https://perma.cc/3CYG-RMYT] (stating that the President laid out a framework for business tax proposing to increase that amount to $500,000 and make immediate expensing permanent); OFFICE OF MGMT. & BUDGET, FISCAL YEAR 2016 BUDGET OF THE U.S. GOVERNMENT (2015), https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/budget.pdf [https://perma.cc/K66P-VTDJ] (proposing to expand and make permanent § 179 expensing to allow businesses to expense up to $1 million of investment in equipment in the first year); Kelly Phillips Erb, *Obama Budget Proposal Tackles Small Business, Changes to IRS*, FORBES (Feb. 3, 2015), http://www.forbes.com/sites/kellyphillipserb/2015/02/03/obama-budget-proposal-tackles-small-business-changes-to-irs/ [https://perma.cc/KT8N-F9AR] (predicting that the budget proposal would be an "easy win").

[10] *See* Mirit Eyal-Cohen, *Why Is Small Business the Chief Business of Congress?*, 43 RUTGERS L.J. 1, 55 (2012) (arguing that favoritism toward small businesses is entrenched in American society due to our nation's philosophy of separation of powers and suspicions about the concentration of power in large firms).

[11] *See* Mirit Eyal-Cohen, *When American Small Business Hit the Jackpot: Taxes, Politics, and the History of Organizational Choice in the 1950s*, 6 PITT. TAX REV. 1, 6 (2008) (describing the conditions that led to the enactment of small business favoritism in the 1950s).

business, and generally declared its aim as stimulating investments for businesses of all sizes.[12] The "small business" affiliation then remained in the section's title for its ideological and rhetorical value.

A distant cousin of the immediate expensing rule, the late Investment Tax Credit ("Investment Credit"), had a different experience. The investment credit was enacted in 1962, suspended in 1966, restored in 1967, repealed in 1969, reinstated in 1971, increased in 1975, and rescinded in the tax reform of 1986.[13] The investment credit never reappeared again despite numerous proposals put forth over the years to reintroduce it. It was part of a cyclical fiscal activism trend that reached its peak between the 1960s and 1980s.[14] Although both measures were enacted as temporary stimulus measures during the same period, immediate expensing survived while the investment credit did not.[15]

This Article starts by asking: What is the reason for these different legislative treatments? The Article argues that the causes were instrumental, ideological, and political. The two tax mechanisms received different legislative action due to the distinct purposes they appeared to serve. Politically, the immediate expensing rule enjoyed bipartisan support throughout history because it was promoted as a small business preference, whereas the investment credit was considered a tax break granted to already profitable businesses to help lower their tax bills. It played an important role during the turbulence of the late 1960s and early 1970s, when the dramatic decline in social capital, trust in government, and taxpayer morale first began.[16] In this David and Goliath matchup, the immediate expensing rule persisted while the investment credit was knocked down.

However, this metaphor does not fully explain the oddity of the two tax rules' histories. This Article identifies two other explanations for the

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[12] GARY GUENTHER, CONG. RESEARCH SERV., THE SECTION 179 AND BONUS DEPRECIATION EXPENSING ALLOWANCES: CURRENT LAW, LEGISLATIVE PROPOSALS IN THE 112TH CONGRESS, AND ECONOMIC EFFECTS 1 (2015), http://usbudgetalert.com/Section%20179%20and%20Bonus%20Depreciation%20Expensing%20Allowances.pdf [https://perma.cc/MDK9-ENCD] (explaining that the requirements governing the use of immediate expensing do not limit the size of the firm that can claim such a benefit, but rather the maximum cost of the property acquired).

[13] *See infra* Appendix fig.2 (charting the history and rate of the investment tax credit from 1962–1986); *see also* Ajay K. Mehrotra & Joseph J. Thorndike, *From Programmatic Reform to Social Science Research: The National Tax Association and the Promise and Perils of Disciplinary Encounters*, 45 LAW & SOC'Y REV. 593, 619 (2011) (describing the public mood that preceded the 1986 tax reform act).

[14] Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1, 11 (1990) (describing the role of the investment credit as part of the evolution of tax instrumentalism).

[15] *See infra* Part III.A (tracing the history of the first time the government applied affirmative fiscal actions in the hope of spurring economic growth).

[16] *See* Ajay K. Mehrotra, *Reviving Fiscal Citizenship*, 113 MICH. L. REV. 943, 970 (2015) (describing historic changes in taxpayers' notions of citizenship).

anomaly. It focuses on ideological changes in tax policy and the emergence of New Economics theory in the 1960s that put a growing focus on economic stimulus.[17] It also recognizes that the intricate nature of the tax credit rendered it too difficult to comprehend and administer.[18] The failure of the investment credit was greatly attributed to its complexity, and to a build-up of public disdain for cyclical legislation and fiscal activism.[19] New Economics theory emerged in the 1960s and prescribed increased monetary, economic, and fiscal actions.[20] It shifted the focus from a passive tax policy to a more active fiscal agenda.[21] With the support of the Council of Economic Advisers, the government started utilizing the tax system as an impetus of "functional economic calibration" to counter economic cycles.[22]

The investment credit symbolized a failed experiment in New Economics theory and an unwanted government market intervention through cyclical fiscal activism.[23] The demise of faith in the ability of government to use tax measures to counter cyclical effects in the economy

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[17] Stanley S. Surrey, *Federal Tax Policy in the 1960s*, 15 BUFF. L. REV. 477, 478 (1966).

[18] *See infra* Part III.B (documenting that from its inception the investment credit attracted much criticism).

[19] Referring in this Article to the active use of tax measures to affect and manage the economic market. *See infra* Part II; *see also* Shaviro, *supra* note 14, at 12 (describing the roots of cyclical legislation in the 1961 Kennedy tax proposals).

[20] *See infra* Part III.A (describing the radical objective of New Economics theory to influence economic growth through federal spending and taxes); *see also* Shaviro, *supra* note 14, at 59 ("[G]overnment can rely on a variety of fiscal illusions, or means of imposing costs indirectly and otherwise camouflaging them in order to avoid public scrutiny. Examples include: increased withholding; inflation (the preferred method of the late 1960s and 1970s); deficit spending (the preferred method of the 1980s); and taxes whose incidence is disguised or unclear (for example the corporate income tax . . . ." (footnotes omitted)).

[21] *See* Mehrotra & Thorndike, *supra* note 13, at 594 (describing a similar economic emphasis that took over the National Tax Association (NTA) agenda).

[22] *See, e.g.*, *Hearings on the President's 1967 Tax Proposals Before the H. Comm. on Ways & Means*, 90th Cong. 518–22 (1967) [hereinafter *Hearings on the President's 1967 Tax Proposals*] (statement of Joseph A. Pechman, Director of Economic Studies, Brookings Institution) (providing support for federal use of tax policy as an instrument to maintain economic stability); *see also infra* Part III (describing critics' claims that economic forecasts were speculative and inaccurate due to time lags).

[23] *See* Shaviro, *supra* note 14, at 15 ("The Kennedy approach, however, today is recognized as . . . fundamentally flawed. A non-universal investment incentive (such as one that favors investments in machines but not human capital, and that does not benefit companies, such as newly founded ones, that have no tax liability to offset) tends to shift the allocation of investment, leading to reductions in its profitability before tax, far more than to increase the amount of investment."); *see also* George E. Zeitlin et al., *Federal Income Taxation*, 1967 ANN. SURV. AM. L. 717, 719 ("Late in 1966, when the theory of the new economics was invoked to justify the temporary suspension of the originally unpopular investment tax credit in order to restrain capital investment then considered to be straining the balance of the economy, it again seemed successful, but there were ominous rumblings." (footnotes omitted)).

led Congress to abandon the investment credit.[24] Yet, the immediate expensing rule has continued into the present, notwithstanding a lack of clear evidence regarding its efficiency in stimulating new market demand.[25] The expensing rule benefited from small business path dependency.[26] This favoritism toward the "little guy" was reinforced throughout history by the Small Business Administration (SBA) and small business congressional committees that helped sustain other small business preferences similar to the expensing rule.[27]

Once introduced, investment incentives tend to become entrenched in our tax system and are politically difficult to retract.[28] The debates during the recent "fiscal cliff" demonstrated this truism.[29] Such maxims are

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[24] *See, e.g.*, Alan J. Auerbach, *The New Economics of Accelerated Depreciation*, 23 B.C. L. REV. 1327, 1346–48 tbls.5, 6 (1982) (criticizing the effect of investment tax incentives and demonstrating that the present value of investment incentives such as the investment tax credit produced a negative effective tax rate); Daniel L. Simmons, *Is It Really Reform? A Theoretical Overview of the 1986 Tax Reform Act*, 1987 BYU L. REV. 151, 194 n.198 (The Reagan Plan [proposed to] repeal[] ACRS and the investment tax credit and adopt[] a 'Capital Cost Recovery System' (CCRS) that utilized shorter recovery periods than the Treasury Proposal.").

[25] *See supra* notes 6, 12 and accompanying text.

[26] *See* Eyal-Cohen, *supra* note 10, at 3–4 (describing the process of small business path dependency through the mechanism of the Small Business Investment Company).

[27] *See* Mirit Eyal-Cohen, *Down-Sizing the "Little Guy" Myth in Legal Definitions*, 98 IOWA L. REV. 1041 *passim* (2013) (providing examples of the numerous small business preferences in U.S. laws).

[28] *See, e.g.*, *Revenue Act of 1962: Hearing on H.R. 10650 Before the S. Comm. on Fin.*, 87th Cong. 2912 (1962) [hereinafter *Hearing on Revenue Act of 1962*] (statement of Paul D. Seghers, President, Institute of U.S. Taxation of Foreign Income, Inc.) ("When you start a subsidy, it is hard to stop it. We don't stop subsidies."); Ryan Alexander, *'Temporary' Tax Extenders Permanently Cost Taxpayers Big*, U.S. NEWS & WORLD REP. (Dec. 10, 2014), http://www.usnews.com/opinion/economic-intelligence/2014/12/10/temporary-tax-extenders-sailing-through-congress-again [https://perma.cc/JF8J-QQYU] (stating that tax extenders package contradicts fairness and honesty in tax policy); Len Burman, *The Politics and Policy of Tax Extenders*, FORBES (Dec. 1, 2014), http://www.forbes.com/sites/beltway/2014/12/01/the-politics-and-policy-of-tax-extenders [https://perma.cc/Y965-4EUR] (referring to tax extenders as "'Tis the season for bad tax policy"); Victor Fleischer, *Tax Extenders* (San Diego Legal Studies Paper No. 14-159, 2014), http://ssrn.com/abstract=2433167 [https://perma.cc/6UJ3-FD9P] (stating that extenders allow members of the tax-writing committees "to shape tax policy in small, incremental ways, to raise campaign funds, and to quietly pay favors to well-connected industries—all without unduly disrupting the . . . 'standing on principle' . . . that created gridlock in the first place").

[29] *See, e.g.*, Richard Q. Lewis III, *Are Tax Expenditures Reaching Their Goals? A View from the Fiscal Cliff*, FLA. B.J., Apr. 2013, at 28, 31 ("Using the tax code as a policy tool, the government has sought, among other aspirations, to increase home ownership and college enrollment among low- and middle-class taxpayers."); Conrad de Aenlle, *For Small Businesses, Tax Law Has Become a Moving Target*, N.Y. TIMES (Feb. 9, 2013), http://www.nytimes.com/2013/02/10/business/yourtaxes/for-small-businesses-tax-law-has-become-a-moving-target.html?_r=0 [http://web.archive.org/web/20130214052230/http://www.nytimes.com/2013/02/10/business/yourtaxes/for-small-businesses-tax-law-has-become-a-moving-target.html?_r=0] (describing how both § 179 deductions and bonus depreciation allow expenses to be written off immediately rather than depreciate gradually); J.D. Harrison, *How the 'Fiscal Cliff' Deal Affects Entrepreneurs and Small Businesses*, WASH. POST (Jan. 2, 2013), https://www.washingtonpost.com/business/on-small-business/how-the-fiscal-cliff-deal-affects-entrepre

particularly prominent in current tax reform proposals put forth to significantly increase and permanently extend investment incentives such as immediate expensing and bonus depreciation.[30] These proposals continue to ignite present debates in the media, contributing to some of the largest tax expenditures in the U.S. budget.[31] The ability to write off

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neurs-and-small-businesses/2013/01/02/27814a74-548d-11e2-8b9e-dd8773594efc_story.html [https://perma.cc/5CQN-GXSB] (reporting Congress's attempts to appease small business by providing extension of immediate expensing and bonus depreciation in order to provide a boost for small employers planning to invest back into their firms in 2013); Don Lee & Jim Puzzanghera, *'Cliff' Deal Lifts Stocks and Doubts: Spending and Hiring Are Expected to Suffer over Uncertainties About the U.S. Debt*, L.A. TIMES (Jan. 2, 2013), http://articles.latimes.com/2013/jan/02/business/la-fi-fiscal-cliff-economy-20130103 [https://perma.cc/N3LF-N2XX] (describing how bonus depreciation is aimed at reversing the trend of decreased business spending on equipment).

[30] DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS 21 (2014), http://www.treasury.gov/resource-center/tax-policy/documents/general-explanations-fy2015.pdf [https://perma.cc/6VA2-UVS9]; THE WHITE HOUSE & U.S. DEP'T OF THE TREASURY, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM 16 (2012) [hereinafter PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM], https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf; JOINT COMM. ON TAXATION, 113TH CONG., REPORT TO THE HOUSE COMMITTEE ON WAYS AND MEANS ON PRESENT LAW AND SUGGESTIONS FOR REFORM SUBMITTED TO THE TAX REFORM WORKING GROUPS 285 (2013), https://www.jct.gov/publications.html?func=startdown&id=4517 [https://perma.cc/5XZU-XAA5]; *see also* Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 22 (creating the initial bonus depreciation allowance of 30% in 26 U.S.C. § 168(k)). The allowance was increased to 50% and extended as part of the Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 756. The bonus depreciation was extended in the Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 619, the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 334, the Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2559, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3304, and most recently the Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, 128 Stat. 4010.

[31] *See, e.g.*, Binyamin Appelbaum, *Tax Break Increases Deficit, but May Have a Silver Lining*, N.Y. TIMES (Feb. 3, 2012), http://www.nytimes.com/2012/02/04/business/corporate-tax-break-on-equipment-may-have-silver-lining.html [http://web.archive.org/web/20151105125427/http://www.nytimes.com/2012/02/04/business/corporate-tax-break-on-equipment-may-have-silver-lining.html] (describing the bonus depreciation as a tax subsidy); J.D. Harrison, *Both Parties Want to Make Business Tax Breaks Permanent. Here's Why They Won't*, WASH. POST (Feb. 24, 2015), https://www.washingtonpost.com/news/on-small-business/wp/2015/02/24/both-parties-want-to-make-small-business-tax-breaks-permanent-heres-why-they-wont/ [https://perma.cc/F7JF-GKS7] (describing partisan controversy over extending business tax breaks and whether to offset the costs); John D. McKinnon, *House Committee Approves Permanent Depreciation Tax Break: Proposal Allowing Businesses to Deduct 50% of Capital Purchases Up Front Heads to Full Senate*, WALL ST. J. (May 29, 2014), http://www.wsj.com/articles/house-committee-approves-permanent-depreciation-tax-break-1401388593 [http://web.archive.org/web/20150909092955/http://www.wsj.com/articles/house-committee-approves-permanent-depreciation-tax-break-1401388593] (describing Congressional uncertainty on whether to permanently extend tax breaks); Maxwell Murphy & Emily Chasan, *Clock Is Ticking on Some Major Tax Breaks*, WALL ST. J. (Oct. 29, 2013), http://www.wsj.com/articles/SB10001424052702304470504579163663724949706 [http://web.archive.org/web/20150709001728/http://www.wsj.com/articles/SB10001424052702304470504579163663724949706] (describing how uncertainty over Congress extending temporary tax credits makes business forecasting more difficult because of potential risks); William Perrey Pendley & Robert Elliot, *The True 'Reagan Way' with the Climate*, WASH. POST (Mar. 18, 2015), https://www.washingtonpost.com/opinions/the-true-reagan-

investments is a valuable benefit for taxpayers—and costly to society.[32] Scholars questioned whether the tax system should provide such incentives and continue to extend them when there is little indication of their success in stimulating growth.[33] These discussions also considered non-tax

way-with-the-climate/2015/03/18/aabef8ec-cc1c-11e4-8730-4f473416e759_story.html [https://perma.cc/7VFP-H5EV] (highlighting two opposing views to George P. Shultz's commentary on President Reagan's economic problem-solving approach); Laura Saunders, *The Tax Mess Deepens*, WALL ST. J. (Nov. 26, 2011), http://www.wsj.com/articles/SB10001424052970203710704577054183310576476 [https://perma.cc/S7WQ-EK8F] (describing how to navigate the economic uncertainty caused by political indecision on the fate of tax code); Bill Smith, *Small Business Advice: Hurry, These Four Tax Breaks Expire at the End of the Year*, WASH. POST (Nov. 26, 2013), https://www.washingtonpost.com/business/on-small-business/small-business-advice-hurry-these-four-tax-breaks-expire-at-the-end-of-the-year/2013/11/25/a2fa85c0-5613-11e3-ba82-16ed03681809_story.html [https://perma.cc/4YKN-XY5B] (describing how economic pressure and political gridlock bode ill for tax provision extension and the resulting challenge to business owners to plan accordingly); Tony Nitti, *President Obama's Plan for Corporate Tax Reform: A 'Grand Bargain' or Simply Another Name for an Old Proposal?*, FORBES (July 30, 2013), http://www.forbes.com/sites/anthonynitti/2013/07/30/president-obamas-plan-for-corporate-tax-reform-a-grand-bargain-or-simply-another-name-for-an-old-proposal/ [http://web.archive.org/web/20130911155356/http://www.forbes.com/sites/anthonynitti/2013/07/30/president-obamas-plan-for-corporate-tax-reform-a-grand-bargain-or-simply-another-name-for-an-old-proposal] (analyzing President Obama's plan to reduce corporate tax rates and use additional tax revenue to create jobs for the middle class); Kyle Pomerleau, *The Basics of Chairman Camp's Tax Reform Plan*, TAX POL'Y BLOG (Feb. 26, 2014), http://taxfoundation.org/blog/basics-chairman-camp-s-tax-reform-plan [https://perma.cc/W3CS-2CVH] (describing how Chairman Camp's plan to simplify the federal tax code while maintaining revenue neutrality ignores and exacerbated tax code complexity).

[32] *See* COMM. ON WAYS & MEANS, SECTION-BY-SECTION SUMMARY OF H.R. 5771, at 4 (2014), https://rules.house.gov/sites/republicans.rules.house.gov/files/113-2/PDF/113-HR5771-SxS.pdf [https://perma.cc/JC9C-5K5G] (stating that according to the Joint Committee on Taxation, extending the immediate expensing provision would reduce revenues by $1.434 billion over 2015–2024); Joseph Bankman, *The Case Against Passive Investments: A Critical Appraisal of the Passive Loss Restrictions*, 42 STAN. L. REV. 15, 32 (1990) ("The liberal system of depreciation and investment tax credit associated with certain assets helped reduce the share of the tax burden borne by the nation's corporations from 23 percent to about 8 percent. Corporations undoubtedly factored favorable tax consequences into marginal decisions on asset purchases."); *id.* at 32 n.83 ("[F]avored assets have been those assets eligible for depreciation or investment tax credit."); Robert J. Peroni, *A Policy Critique of the Section 469 Passive Loss Rules*, 62 S. CAL. L. REV. 1, 9 n.27 (1988) ("[T]he combination of ACRS depreciation and the investment tax credit (ITC) provided the taxpayer with total benefits that were, even before taking into account the effects of leverage, more valuable than expensing for many types of depreciable equipment.").

[33] *See, e.g.*, Michelle Hanlon & Shane Heitzman, *A Review of Tax Research*, 50 J. ACCT. & ECON. 127, 148 (2010) (arguing certain provisions appear to have increased investment in some favored assets but not aggregate investment); Anthony C. Infanti, *Tax Reform Discourse*, 32 VA. TAX REV. 205, 212 (2012) (noting tax incentives encourage investment in capital at the expense of investment in labor); Erik M. Jensen, *Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating the Alternatives*, 57 ST. LOUIS U. L.J. 1, 5 n.27 (2012) ("[Certain provisions] created an extraordinary incentive for investment in property that, were it not for the tax break, would make no economic sense . . . [and] left 'cost recovery' for another universe."); Calvin H. Johnson, *Taxing GE and Other Masters of the Universe*, 132 TAX NOTES 175, 183–84 (2011) (pointing to the negative impact and the bias of investment incentives on the effective corporate tax rate); Yoram Margalioth, *Not a Panacea for Economic Growth: The Case of Accelerated Depreciation*, 26 VA. TAX REV. 493 (2007) (arguing that accelerated depreciation is based on a questionable economic growth theory); Seto, *supra* note 3, at 782–83 (arguing investment tax incentives have the effect of creating "jobless recoveries" by shifting

alternatives in the pursuit of the optimal form to incentivize behavior.[34] This Article seeks to shed new light on these discussions. It identifies factors that not only enrich the debate on the use of the tax system to influence taxpayers' behavior, but also provides policymakers with historical insights.

The Article proceeds as follows. Part II discusses the depiction of the immediate expensing rule in legislative history as a small business measure and the emergence of the investment credit. Part III describes the political settings and unfolds the shift in tax ideology toward cyclical fiscal activism under the New Economics theory. Part IV describes the experimentation with calibrating fiscal policy represented by the use of the convoluted test case of the investment credit. Part V concludes by providing insights regarding the two narratives alongside the current debate over utilizing investment tax incentives.

II. THE POLITICS OF SMALL BUSINESS INVESTMENT INCENTIVES

Immediate expensing is an extreme form of depreciation. It works to recover the cost of the acquired property over shorter-than-usual recovery periods, thereby providing taxpayers with the advantage of the time value of money.[35] For example, as of 2010, taxpayers are permitted immediate expensing of up to $500,000 of qualified property that cost up to $2 million.[36] Accordingly, they can expense the cost of capital investments until those total expenditures reach $2,500,000.[37]

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businesses toward greater use of capital and less use of labor); George K. Yin, *Temporary-Effect Legislation, Political Accountability, and Fiscal Restraint*, 84 N.Y.U. L. REV. 174, 245 (2009) (claiming that investment incentives' uncertainty can spur investment). *But see* Michael J. Graetz & Rachael Doud, *Technological Innovation, International Competition, and the Challenges of International Income Taxation*, 113 COLUM. L. REV. 347, 375 (2013) ("[Incentives foster] nations choos[ing] to subsidize technological innovation because, in the absence of such subsidies, crucial research and development would be underproduced."); Christopher L. House & Matthew D. Shapiro, *Temporary Investment Tax Incentives: Theory with Evidence from Bonus Depreciation*, 98 AM. ECON. REV. 737, 762–63 (2008) (holding that the expiration of temporary tax incentives accelerates the subsidized activity); Tom C.W. Lin, *The New Financial Industry*, 65 ALA. L. REV. 567, 616 (2014) ("[A]n incentive-based approach would be to encourage industry participants to enhance their cyber defense by . . . allowing participants to . . . [use] bonus depreciation . . . .").

[34] *See, e.g.*, Steven Ferrey, *The New Climate Metric: The Sustainable Corporation and Energy*, 46 WAKE FOREST L. REV. 383, 405 (2011) (pointing out the economic effect of investment incentives for renewable energy equipment); Brian Galle, *The Tragedy of the Carrots: Economics and Politics in the Choice of Price Instruments*, 64 STAN. L. REV. 797, 835 (2012) (discussing the delay in response to certain tax incentives when designing a tax system comprised of sticks and carrots).

[35] GUENTHER, *supra* note 12, at 1.

[36] *See supra* note 9 and accompanying text. The following laws extended the immediate expensing maximum limits to these levels: Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 201(a), 124 Stat. 71, 77 (2010); Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 2021(a)–(d), 124 Stat. 2504, 2556–2558; Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, §§ 402(a)–(e), 737(b)(3), 124 Stat. 3296, 3306, 3318;

This Part tracks the historical roots of the immediate expensing rule and the investment credit. It focuses on the role that small businesses played in the enactment and persistence of the immediate expensing rule, compared to other capital investment incentives that did not benefit from such affiliation. Specifically, it points to political rhetoric used to portray immediate expensing as a temporary and simple small business tax preference. Expensing was meant to help small business retain internal earnings for equipment replacement and expansion, while the investment credit was viewed as a big business subsidy.

A. *Recessions and the Obsolescence Gap*

The concept of faster-than-normal depreciation, or rapid amortization, appeared during times of crisis, primarily during World Wars I and II.[38] The government began to offer "write-off certificates" as a way of assisting companies that installed plants exclusively for wartime use.[39] At that time, economists began to point out a major gap between the capital recovery rules set by the Internal Revenue Code ("Code") and the actual wear and tear of the property, especially in the first year the property was placed in service, also known as the "obsolescence gap."[40] Many foreign nations addressed the first-year obsolescence problem by providing

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American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 315(a)–(d), 126 Stat. 2313, 2330–31; Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, § 127(a)–(d), 128 Stat. 4010, 4017.

[37] I.R.C. § 179(b)(1)–(2) (2012). A taxpayer who purchased equipment for $650,000 could expense $500,000 immediately during the first year in which the property was placed in service. In addition, the taxpayer could utilize the bonus depreciation, which allowed taxpayers to deduct an additional 50% of their cost of qualified property in the first year of service. I.R.C. § 168(k) (2012). Thus, another $150,000 bonus depreciation expense transported the entire purchase to an immediate write-off in lieu of recovering the cost of the equipment over its useful life. Assuming a 35% tax rate, and that the taxpayer had a positive income this year against which he or she could take this immediate deduction, the taxpayer could benefit from total tax savings of $227,500, and a net cost for the equipment of $422,500, greatly lowering the effective tax rate on income derived from the investment in this equipment. $650,000 x 35% = $227,500 tax savings results in $650,000 – $227,500 = $422,500 after-tax cost for the equipment. *See generally* THEODORE P. SETO, FEDERAL INCOME TAXATION: CASES, PROBLEMS, AND MATERIALS 265 (2012) (describing the emergence, history and projected fate of the bonus depreciation expensing rule).

[38] JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 148 (1985).

[39] With the end of World War II, rapid depreciation was not restored until the Korean War broke out in 1950, and even then was applied only to defense facilities. Overall, very few certificates of necessity granting rapid write-offs have been issued. The Defense Production Act of 1940, ch. 508, § 6, 54 Stat. 712, 714, somewhat alleviated the situation by allowing a five-year write-off of war and defense plants. *See President's 1961 Tax Recommendations: Hearings Before the H. Comm. on Ways & Means on Tax Recommendations of the President Contained in His Message Transmitted to the Congress, April 20, 1961*, 87th Cong. 987 (1961) [hereinafter *1961 House Hearings*] (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) (describing the need to increase depreciation allowances, and explaining that the United States lagged behind other countries).

[40] Joel Barlow, *The Role of the Investment Credit: The Gap to Be Filled if It Is Repealed, in* PROCEEDINGS OF THE SIXTY-SECOND ANNUAL CONFERENCE ON TAXATION, at 649, 649 (1970).

additional initial allowances of 10%–55%.[41] Yet, under the Code, there remained a need to provide evidence of additional technological obsolescence to deviate from normal depreciation schedules.[42] This was a major competitive hurdle and a principal deficiency of the old depreciation system.[43]

Technological obsolescence was a direct consequence and a major part of postwar industrial inefficiencies.[44] With the rapid advance of industry and the scientific-technical revolution of the 1940s, there was a growing need to update and replace old machinery.[45] Studies indicated that the modernization of U.S. industry was greatly needed at that time; American industry was in the process of "produc[ing] modern weapons of the atomic and space age with ineffective and obsolete tools."[46] However, even when new equipment was purchased, rapid wear and tear usually occurred in the first year of its life.[47]

The U.S. economy saw a capital investment boom in the years following World War II.[48] Rates of plant and equipment expenditures were at their height.[49] However, overproduction by large industrial firms and a series of natural disasters resulted in the American economy entering a

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[41] *Id.* at 666.

[42] *1961 House Hearings*, *supra* note 39, at 989–90 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) (explaining the need and difficulty of proving the cost of technological obsolescence).

[43] *Id.* ("Although the [technological] obsolescence will inevitably take place in this first year, it simply cannot be proved, but only predicted, at the time the facility is acquired.").

[44] *Good Stocks Still Belong in Balanced Program*, 96 TR. & EST. 245, 245 (1957) (reporting from the ABA Trust Conference on professionals complaining that "because of the too rapid obsolescence factor caused by accelerated technological advances" some industries are inferior).

[45] *See 1961 House Hearings*, *supra* note 39, at 1546 (statement of Aerospace Industry Association).

[46] *Id.* at 1544 (statement of George E. Merryweather, President, American Machine Tool Distributors' Association); *see also Tax Problems of Small Business: Hearing Before a Subcomm. of the Select Comm. on Small Bus.*, 82d Cong. 528 (1952) [hereinafter *Tax Problems of Small Business*] (statement of Rep. Frances P. Bolton) (arguing for optional depreciation in place of prevailing tax regulations on depreciation in order to maintain the nation's war readiness); Lowell E. Sachnoff, *Extraordinary Obsolescence, Rate-Making and the Atomic Reactor*, 25 U. CHI. L. REV. 269, 269–70 (1958) (predicting extraordinary obsolescence in the atomic industry due to unanticipated technological advances).

[47] WITTE, *supra* note 38, at 146.

[48] *See infra* Appendix fig.3. Furthermore, the Internal Revenue Code of 1954 shifted the burden of proof of depreciation to the government, added clarification of criteria for application of the penalty tax, and provided a minimum amount that would not be subject to the accumulated earnings tax. S. REP. NO. 83-1622, at 26, 68–72 (1954).

[49] *See infra* Appendix fig.3 (showing a peak in business expenditures in new plant and equipment of over $45 billion in 1958); *see also* Arthur F. Burns, *The Current Business Recession*, 31 J. BUS. 145, 145 (1958) (noting a "great burst of economic activity" following a short recession upon the conclusion of hostilities in Korea).

period of deep recession.[50] In 1957, industrial production severely plummeted, prices on the New York Stock Exchange dropped, and consumer prices rose to record levels.[51] In 1958, the number of business failures reached over 1,200 a month, the highest rate since 1933,[52] and unemployment reached 7.5%.[53] Small businesses accounted for the majority of the business failures around this time;[54] representatives of small business appeared before congressional committees and presented a gloomy picture of their affairs,[55] attesting that they had had to borrow funds in order to pay taxes, purchase equipment, and continue operations.[56]

Financing the replacement of machinery and equipment turned out to be a challenging task, especially for small businesses that relied on their internal earnings.[57] Professionals, scholars, and businesspersons urged the Treasury Department to provide faster depreciation schedules; they saw the solution to the obsolescence gap as permitting the recovery of the

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[50] In 1955 and 1956, a series of natural disasters aggravated the economic condition of small businesses. Hurricanes hit the Atlantic coast and heavy rains fell on the west coast, causing severe floods and destruction. *See generally* Gordon E. Dunn et al., *Hurricanes of 1955*, 83 MONTHLY WEATHER REV. 315, 315 (1955) (analyzing the 1955 hurricane season, which at the time was the "the most disastrous in history").

[51] *See Table of Historical Inflation Rates by Month and Year (1914–2015 in %)*, US INFLATION CALCULATOR, http://www.usinflationcalculator.com/inflation/historical-inflation-rates [https://perma.cc/48NF-CBVY] [hereinafter *Table of Historical Inflation Rates*]; *see also* G.L. Bach & Albert Ando, *The Redistributional Effects of Inflation*, 39 REV. ECON. & STAT. 1, 10–11 (1957) (discussing the redistributional effects of inflation in those years by comparing the performance of creditor and debtor companies and shifts between each group).

[52] *See* Richard Sutch, *Business Incorporations and Failures—Numbers and Liabilities: 1857–1998*, HIST. STAT. U.S., http://hsus.cambridge.org/HSUSWeb/toc/tableToc.do?id=Ch408-413 [https://perma.cc/5ZX4-2TLA] (last visited Oct. 12, 2015).

[53] *Civilian Unemployment Rate*, BUREAU LAB. STAT., http://research.stlouisfed.org/fred2/data/UNRATE.txt [http://web.archive.org/web/20160414014932/http://research.stlouisfed.org/fred2/data/UNRATE.txt] (last visited Apr. 10, 2016).

[54] *Keeping the Records Straight*, TIME, Aug. 20, 1956, at 84; *Needed: Talent, Training & Tax Cuts*, TIME, Nov. 12, 1956, at 100 ("[T]he newest figures on small business are cause for some alarm.").

[55] *See* Richard Sanzo, *Small Business: Alive and Not Kicking*, MGMT. REV., Dec. 1957, at 30, 30 ("[I]s small business really thinking of cashing in its chips—or is it staking them hopefully on the future?"); *see generally Tax Slash for Smaller Firms Asked*, L.A. TIMES, Oct. 25, 1956, at B1 (detailing conference featuring calls for increased availability of government contracts to small businesses); *The 'Little Fellow'*, N.Y. TIMES, Jan. 2, 1957, at 97 (describing the reasons small businesses were struggling and anticipating Congressional intervention).

[56] *See Tax Problems of Small Business: Hearing Before the Select Comm. on Small Bus.*, 85th Cong. 617 (1958) (statement of J.W. Barfield, President, Barfield Instrument Corp.) (explaining small businesses' inability to afford taxes after investing in equipment and expansion and noting the difficulty for such businesses to obtain loans). For a survey of small business arguments, see Richard Rutter, *The 'Little Man' Keeps His Chin Up*, N.Y. TIMES, Mar. 30, 1958, at F1.

[57] *1961 House Hearings*, *supra* note 39, at 987 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce).

investment in a shorter time.[58] The Commerce Department identified two main reasons for the post-World War II equipment-replacement problem: the rise of inflation and the rapid rate of obsolescence with the advance of technology.[59] Consequently, it acted to revise depreciation policy and to provide investment incentives to maintain the competitive position of the United States relative to the rest of the world.[60]

The recessionary years of the late 1950s, and the financial predicaments of that time, found Congress in a "mood" to help and encourage small business,[61] and augmented its sense of responsibility to their well-being.[62] The introduction of massive small business tax preferences in 1958 was a major part of Congress's plan for national economic recovery.[63] At that time, Congress viewed small business as an important element in stimulating economic activity and creating jobs. Therefore, Congress viewed helping small businesses as assisting the recovery of the economy.[64] The next subpart depicts the creation of the expensing rule as a route Congress took to address some of these issues.

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[58] *See generally* Arthur H. Dean, *Provision for Capital Exhaustion Under Changing Price Levels*, 65 HARV. L. REV. 1339, 1346–48 (1952) (discussing concepts of equity in taxation of capital exhaustion); Louis L. Jaffe, *The Effective Limits of the Administrative Process: A Reevaluation*, 67 HARV. L. REV. 1105, 1124 (1954) ("It is often asserted that industry suppresses innovations which may cause capital or inventory obsolescence."); Richard M. Rothschild, *The Case for the Declining Balance*, 33 TAXES 502, 512 (1955) (emphasizing the significance of obsolescence as the most important factor in depreciation).

[59] *See Machine-Tool Programs: Hearings Before a Subcomm. of the Select Comm. on Small Bus.*, 84th Cong. 101–02 (1956) (statement of James C. Kelley, General Manager, American Machine Tool Distributors' Association) (describing the problem of replacing obsolete equipment before recovering its cost due to depreciation tax policy); *Tax Problems of Small Business*, *supra* note 46, at 529 (statement of Rep. Bolton) (blaming obsolescence in the machine-tool industry on tax regulations requiring owners to predict when machinery will become obsolete).

[60] *Cf. 1961 House Hearings*, *supra* note 39, at 1022 (statement of Benjamin A. Javits, President, United Shareholders of America) ("In order to meet the economic challenge from the Communist nations . . . the matter of tax depreciation on machinery and equipment is fundamental and vital and needs thorough overhauling").

[61] Eyal-Cohen, *supra* note 11, at 45.

[62] For example, the government approved many expansions of the SBA loan program during the 1960s to address the tight credit problem of small firms. *See, e.g.*, *Small Business Agency Loan Ceiling Increase Is Approved by House*, WALL ST. J., July 3, 1962, at 3; *Small Business Agency Loan Ceiling Raised $250 Million by Senate*, WALL ST. J., June 15, 1962, at 14; *House Unit Votes to Raise SBA's Ceiling on Loans*, WALL ST. J., June 8, 1962, at 26. *But see Small Business Agency Curbs Loans to Firm; Cites Disaster Lending*, WALL ST. J., Nov. 10, 1964, at 3 (describing a decrease in SBA loan funding for small firms in order to set aside funds for disaster lending).

[63] STAFFS OF THE JOINT COMM. ON INTERNAL REVENUE TAXATION & THE TREASURY DEP'T, 84TH CONG., LIST OF SUBSTANTIVE UNINTENDED BENEFITS AND HARDSHIPS AND ADDITIONAL PROBLEMS FOR THE TECHNICAL AMENDMENTS BILL OF 1957, at 14 (Comm. Print 1956) [hereinafter SUBSTANTIVE UNINTENDED BENEFITS].

[64] *See, e.g.*, 104 CONG. REC. 249–50 (1958) (statement of Sen. Fulbright) (identifying the success of small businesses as a means of strengthening the national economy and proposing a bill to help small businesses remain competitive with larger businesses).

B. *The Birth of the Immediate Expensing Rule*

The abundance of small business favoritism is a result of politics.[65] The exalted status of small business as a bedrock of America protected the expiration of temporary small business preferences such as immediate expensing. Pursuant to public choice theory, over the years politicians have been beholden to the interests of their constituents,[66] many of whom own, operate, or work for a small business; and, indeed, there is some historical evidence to this effect.[67] No politician wants to be seen attacking "Main Streets across America"[68] and taking money away from small businesses that are regarded popularly as "the engine of job creation in this country."[69]

Small business culture developed from our nation's philosophy of separation of powers, one of the bases of our democracy. Throughout history, suspicions about the concentration of power led the government to favor small firms, viewing them as guardians of fair competition and free society.[70] Natural disasters and economic shocks reinforced preconceived notions that small businesses had to be salvaged whenever events out of the government's control harmed their well-being.[71] Over the years, the

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[65] Ronald F. Wilson, *Federal Tax Policy: The Political Influence of American Small Business*, 37 S. TEX. L. REV. 15, 32–33 (1996) (discussing the influence of small business organizations). *See generally* Eyal-Cohen, *supra* note 10 (describing the politics behind small business favoritism).

[66] *See* Phillip Shabecoff, *S.B.A. Under Fire: Program to Assist Minorities Discounted*, N.Y. TIMES, May 16, 1971, at F3 (detailing the contention between representatives of districts with a large African-American constituency and those with a mainly white constituency); *see also* Irwin L. Kellner, *A Bright Forecast for Small Businesses*, N.Y. TIMES, June 24, 1984, at LI20 (avowing the notion that the business of our country is small business).

[67] *See* Ronald F. Wilson, *Federal Tax Policy: The Political Influence of American Small Business*, 37 S. TEX. L. REV. 15, 32–33 (1996) (discussing the influence of small business organizations); *see also* Eyal-Cohen, *supra* note 10 (describing the politics behind small business favoritism).

[68] Press Release, U.S. Senate Comm. on Small Bus. & Entrepreneurship, LeMieux, Landrieu, Senate Democrats Fight to Include Credit Relief for Small Businesses (July 22, 2010), http://www.sbc.senate.gov/public/index.cfm?p=PressReleases&ContentRecord_id=5bd6bbe9-fe06-4282-be7d-df5b8b607a70 [https://perma.cc/3KKG-H55R] (statement of Sen. Patty Murray (D-WA)).

[69] *Id.* (statement of Sen. Amy Klobuchar (D-MN)). *But see* Alex LaBeau, *Be Wary of Political 'Small Business' Panderers*, IDAHO PRESS-TRIBUNE (July 16, 2010), http://www.idahopress.com/opinion/bestread/be-wary-of-political-small-business-panderers-take-poll-at/article_d5fa54d8-9068-11df-9add-001cc4c002e0.html [http://web.archive.org/web/20160427205804/http://www.idahopress.com/opinion/bestread/be-wary-of-political-small-business-panderers-take-poll-at/article_d5fa54d8-9068-11df-9add-001cc4c002e0.html] ("In reality, the real cynical political motivation for touting 'small business' is to create an 'us versus them' mentality that is not only a misrepresentation of reality, but a dangerous path of rhetoric that leads to an economic caste system.").

[70] *See* MANSEL G. BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA 11 (2d ed. 2003) ("[T]housands of small, personally owned and operated firms . . . formed the glue of America's business system."); *see also* Frank T. Carlton, *What Is Free Enterprise?*, 3 AM. J. ECON. & SOC. 655, 656 (1944) (discussing the importance of free enterprise to the American dream).

[71] *See* Arthur F. Burns, *The Current Business Recession*, 31 J. BUS. 145, 145–46 (1958) (explaining that a slowdown in production following an economic boom prompted by the end of the Korean War led to businesses failing to meet their expected profits and sales during the second half of 1956 and into 1957); *Needed: Talent, Training & Tax Cuts*, TIME, Nov. 12, 1956, at 98 (detailing the

government expanded its patronage and provided small firms with growing special preferences through the legal system.[72]

The birth of the immediate expensing rule in 1958 is an example of this path dependency. This rule was designed as part of comprehensive and far-reaching tax incentives to encourage and foster small business.[73] The new immediate expensing rule, titled "Additional First-Year Depreciation Allowance for Small Business," permitted businesses, individuals, or corporations that purchased depreciated property with a useful life of at least six years to deduct up to a maximum of $2,000 during the first year when such property was placed in service.[74] Congress hoped this mechanism would encourage additional investment in small business, since it provided for a faster recovery of capital before taxing earnings.[75] Moreover, the immediate expensing rule increased desirable tax simplification for small entities since it saved them the complexities of depreciation calculation and recordkeeping each year by allowing small businesses a one-time deduction when placing the asset in service.[76]

During committee hearings on the topic of depreciation policies, representatives from the machine tool industry, an apparent interest group that benefits from any equipment purchase incentives, argued that depreciation rates did not provide adequate allowances essential for investments in new machinery by small businesses at that time.[77] These representatives supported small businesses by expressing concerns regarding their ability to maintain modern equipment and compete with

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decline in profits experienced by businesses in 1956 and the sentiment of economists that the success of small companies is essential to prosperity). For example, a series of natural disasters in the 1950s exacerbated the economic condition of small businesses. *See* Dunn et al., *supra* note 50, at 315.

[72] Eyal-Cohen, *supra* note 10, at 55.

[73] One such incentive was the creation of the Small Business Corporation by way of the Technical Amendments Act of 1958, Pub. L. No. 85-866, § 64, 72 Stat. 1606, 1650 (codified as amended at 26 U.S.C. § 1361 (2012)); *see also* Small Business Investment Act of 1958, Pub. L. No. 85-699, § 101, 72 Stat. 689, 689 (codified as amended at 15 U.S.C. § 661 (2012)) (forming the Small Business Investment Program).

[74] *See* SELECT COMM. ON SMALL BUS., 85TH CONG., SMALL BUSINESS TAX ADJUSTMENTS 29 (Comm. Print 1958). The benefit offered a $4,000 immediate deduction for an individual filing a joint return. Under this rule, if the cost of the property exceeded $10,000, taxpayers were allowed a maximum of 20% of $10,000. This special allowance was granted to taxpayers on top of the ordinary depreciation permitted under the Code. *Id.* at 28–32.

[75] *Id.* at 29; SUBSTANTIVE UNINTENDED BENEFITS, *supra* note 63, at 6.

[76] *See, e.g.*, *1961 House Hearings*, *supra* note 39, at 1554 (statement of Henry J. Griswold, Chairman, Taxation Committee, Smaller Business Association of New England) ("[T]ax legislation designed to assist small business must provide a realistic means of enabling smaller enterprises to retain a larger proportion of before-tax earnings."); *id.* at 991 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) (emphasizing that smaller companies have more difficulties with the current capital recovery of machinery).

[77] *General Revenue Revision: Hearing on Forty Topics Pertaining to the Gen. Revision of the Internal Revenue Code Before the H. Comm. on Ways & Means*, 83d Cong. 671 (1953).

larger firms.[78] They further emphasized the crucial need to reduce investment risk in small businesses, and to improve their credit condition as a way of stimulating economic growth.[79] One of their proposals was to permit taxpayers greater flexibility in determining the length of the depreciation period, and allow more rapid tax-free recovery on investments.[80]

Soon after its enactment, it became clear that immediate expensing was utilized by more than small businesses.[81] Indeed, there was a politically unified front of businessmen, professionals, and members of the media across parties that supported the measure.[82] The political value of the "small business stock" was on the rise, and any proposal that benefited the proverbial "small business" received wide bipartisan support.[83] Big business organizations concurrently began to push for the expansion of immediate expensing by eliminating the limitation on the maximum amount of the allowed immediate deduction.[84] Clearly, foreign competition was not the primary concern of small business at that time; rather, they were worried about tight credit problems and national competitive hurdles.[85] Nonetheless, the Chamber of Commerce pushed for the expansion of the small business immediate expensing rule in the name of foreign competition.[86] The American Machine Tool Distributors Association, whose constituents were poised to gain greatly from any type of equipment investment incentive, also advocated for the increase in the scope of immediate expensing.[87] They, too, called for a complete removal

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[78] *Id.* at 667–68 (statement of I.D. McDonald, Chairman, Subcommittee on Tax Policy, National Machine Tool Builders' Association).

[79] *Id.* at 670.

[80] *Id.* at 672.

[81] *See* H. COMM. ON WAYS & MEANS, 86TH CONG., TAX REVISION COMPENDIUM: COMPENDIUM OF PAPERS ON BROADENING THE TAX BASE 47–48 (Comm. Print 1959).

[82] *See, e.g.*, *Hearing on Revenue Act of 1962*, *supra* note 28, at 3351 (statement of Raymond Rogers, Professor of Banking, Graduate School of Business Administration, New York University) (stating that immediate tax payments reduce working capital and force smaller firms to borrow at high rates).

[83] *See* Eyal-Cohen, *supra* note 11, at 33–34 (describing how Congress sought to avoid associating small businesses with "rich men's tax," as well as other pro-small business rhetoric).

[84] J. KEITH BUTTERS & JOHN LINTNER, EFFECTS OF FEDERAL TAXES ON GROWING ENTERPRISES 2–4 (1945).

[85] *See* Eyal-Cohen, *supra* note 10, at 21.

[86] *See Revising Tax on Gains from Sales of Depreciable Personal Property: Hearings on H.R. 10491 & H.R. 10492 Before the H. Comm. on Ways & Means*, 86th Cong. 33 (1960) [hereinafter *Revising Tax on Gains from Sales of Depreciable Personal Property*] (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) ("[W]e have to get rid of our outmoded depreciation and replacement practices in this country if we are going to modernize our plants and reduce our costs so as to compete effectively with our foreign competitors.").

[87] *See 1961 House Hearings*, *supra* note 39, at 1544–45 (statement of George E. Merryweather, President, American Machine Tool Distributors' Association) (urging the committee to adopt the

of the maximum limitation on the cost of the property allowed to be expensed, as well as an increase in the amount to be expensed to assist small businesses.[88]

The small business lobby also advocated for immediate expensing and the expansion of its scope. Small business owners praised the new legislation and pleaded with the government to continue to provide them with faster depreciation rules that left them with more internal investment funds to purchase needed equipment and machinery.[89] Conversely, some small business owners testified that, due to its dollar limitation, immediate expensing had a restricted effect on encouraging their expansion.[90] Instead, they advocated for a full write-off of all the costs of the asset during the first year the asset was placed in service.[91]

During committee hearings, professionals and businessmen explained that the retention of earnings by small business was crucial for the purposes of reinvestment and expansion.[92] Because depreciation deductions were spread over the useful life of the property, expansion required additional cash, which made growth more dependent on the business's borrowing power, rather than on its earnings.[93] Small businesses, they emphasized, had an inferior position in borrowing due to

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administration's tax credit proposal by amending I.R.C. § 179, while also recognizing that a complete reform of the tax depreciation structure is also needed).

[88] *See id.* at 1545 ("In summary, we urge that the committee substitute a 30-percent initial allowance deduction for the administration tax credit proposal, by amending section 179 of the code to eliminate the $10,000 and the 6-year useful-life limitations, and by changing the initial allowance rate from 20 percent to at least 30 percent.").

[89] *See Revising Tax on Gains from Sales of Depreciable Personal Property*, *supra* note 86, at 147 (statement of Frank T. Powers, President, Powers Chemco Inc.) ("By reason of the adoption of section 179 my company and certain of its subsidiaries have already ben [sic] enabled to acquire badly needed machine tools and other [immediate expensing] qualified property by tapping investment funds otherwise not available to them.").

[90] *See, e.g.*, *Small Business Problems in Urban Areas: Hearings on H. Res. 13 Before the H. Select Comm. on Small Bus.*, 89th Cong. 690–91 (1965) (statement of Al J. Braxton, CPA, Arthur Andersen & Co.) (explaining that the investment credit is not enough for small businesses, despite being a real incentive for expansion in larger businesses that have capital and financing).

[91] *See Revising Tax on Gains from Sales of Depreciable Personal Property*, *supra* note 86, at 16–17 (statement of Fred C. Scribner, Jr, Under Secretary of the Treasury) (discussing the benefits of one-year write-offs and "salvage value," using the hypothetical of a purchase of an automobile).

[92] *See id.* at 127 (statement of John A. Gosnell, General Counsel, National Small Businessmen's Association) ("The small businessman is dealing with a fact of life, not an abstract theory, and if he is not able to keep profits nor establish an adequate reserve, he is faced with an almost insurmountable problem."); *id.* at 154–55 (statement of E.L. Lester, Jr., E.L. Lester & Co.) (explaining how no longer appreciating the capital invested in depreciable property will burden small businesses by limiting the amount of cash on hand at a given time); *id.* at 155 (statement of Hugh K. Marr, Accountant) ("H.R. 10491 would just be another tax law which, in many instances, could mean the difference in whether or not a small businessman can afford to improve his efficiency by updating, adding to, or improving his business property.").

[93] *See id.* at 135 (statement of Edmund A. Spencer) ("[T]hose operating smaller businesses have not the facilities that big corporations have to borrow money for capital improvements.").

their inherent risk, which left them dependent primarily on internal funding and retained earnings for any type of expansion.[94] Arguably, the tax benefits simply "leveled the playing field" to account for the higher cost of capital to fund small businesses.[95]

Scholars were some of the few skeptics who doubted the effectiveness of the new expensing rule. They argued that while it may result in some allocation of funds for small business growth, it was more likely to postpone the timing of tax reckoning and to serve the machinery and equipment production industry.[96] Thus, if the tax benefit simply accelerated the timing of purchases, rather than increasing the net amount of purchases, it would not have much of an overall long-term stimulative effect.[97] If property was to be purchased every year, it would result in an overall permanent postponement of tax on qualified property.[98] The next subpart describes the concurrent chain of events that eventually led to the enactment of the investment credit.

C. *Enactment of the Investment Tax Credit*

As part of proposals in 1961 to stimulate economic growth and improve the competitive position of the nation's industries, President Kennedy and Treasury Secretary Dillon proposed a new investment credit.[99] On October 16, 1962, the government passed the Revenue Act of 1962, which added § 38 to the Code, providing a new credit of seven percent of the property's cost with at least four years of useful life.[100] In the same year, the Treasury Department also modified the treatment of depreciation, liberalizing depreciable asset lives and the overall approach to the determination of the depreciation deduction.[101]

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[94] *Id.* (explaining that lack of credit is the reason for the disadvantage of small businesses over big corporations).

[95] *See id.* at 147 (statement of Frank T. Powers, President, Powers Chemco Inc.) (discussing the inconsistencies involved in passing new laws after legislation was passed eighteen months prior as a way to assist small businesses).

[96] *See, e.g.*, L. Hart Wright & Jerome B. Libin, *Impact of Recent Tax Stimulants on Modest Enterprises: A New Look for Messrs. Small and Smaller Business*, 57 MICH. L. REV. 1131, 1135, 1138 (1959) (discussing the ultimate effects of the amendment, including, but not limited to, maximizing benefits when one purchases qualified property).

[97] *See id.* at 1135 ("[T]he provision will serve only to postpone the timing of tax reckoning.").

[98] *See id.* (explaining postponement as an effect of the § 179 amendment).

[99] *See* H.R. DOC. NO. 140, at 1–2 (1961) (presenting proposed changes to the House Ways and Means Committee). This message was also reprinted with the committee hearings that took place three weeks after the statement. *See 1961 House Hearings*, *supra* note 39, at 3.

[100] The credit was limited to 100% of the tax liability up to $25,000, plus 25% of any tax liability in excess of $25,000. 26 U.S.C. § 46(a)(2), (c)(2) (1964).

[101] *See* Surrey, *supra* note 17, at 478 (describing this liberalization as a "companion" to the 1962 Act). The 1962 Act also aimed to serve as a substitute for the accelerated depreciation that had been allowed during World War II and the Korean War, such as those found in 26 U.S.C. §§ 23(t), 124(a) (1940).

However, while retaining the view that the primary function of depreciation is to measure net income over time, the Kennedy administration had greater plans in mind for the investment credit. By creating incentives for capital purchases that would not have otherwise occurred, the 1962 Act intended to stimulate growth and create new jobs.[102] Senator Kerr (D-OK), who led the floor debates in the Senate for the administration's tax program, characterized the investment credit as the "most important single measure to strengthen and revitalize the American economy enacted by the 87th Congress."[103] Harvey E. Brazer, Director of the Office of Tax Analysis at the Treasury Department, noted that the administration's goal was to provide a more realistic revision of the depreciation rules and to equalize U.S. business with its foreign competitors in terms of the tax treatment of capital assets.[104] At that time, the United States fell behind the economic growth rate of other leading rival economies such as the Soviet Union, Japan, and Western Europe, which subsidized industrial investments.[105]

Several interest groups supported the enactment of the new tax credit. The American Machine Tool Distributors' Association evidently gained from any kind of equipment purchase incentive, more so when their customers were established businesses with stable, positive tax liability to offset against the investment credit. Their representative appeared before the Ways and Means Committee, emphasizing the connection between national defense and the need for an efficient and effective national production base.[106] When supporting the enactment of the investment credit, the representative argued that the revenue loss from the tax credit could be offset by the savings in cost production resulting from the new machinery and equipment.[107]

Another lobbying group that was set to benefit from the enactment of any type of investment incentive was the National Machine Tool Builders' Association. However, this association believed that the proposed credit was too complex and very limited in its application, due to its many restrictions.[108] Instead, the association urged the committee to expand immediate expensing by eliminating the rule's limitations and allowance

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[102] Harvey E. Brazer, *The 1962 Revision of Depreciation Guidelines*, 15 TAX EXECUTIVE 7, 16 (1962) (explaining the benefits of the two provisions in Section 13 of the Act, as well as the proposed seven percent investment tax credit).

[103] 108 CONG. REC. 18,734 (1962).

[104] Brazer, *supra* note 102, at 16.

[105] *See infra* Part III.B.

[106] *1961 House Hearings*, *supra* note 39, at 1544 (statement of George Merryweather, President, American Machine Tool Distributors' Association).

[107] *Id.* at 1547 (statement of Everett Hicks, President, National Machine Tool Builders' Association).

[108] *Id.* at 1549.

rate.[109] Immediate expensing was described as a more effective and equitable measure, compared to the investment credit.[110] The next Part describes the emergence of the New Economics philosophy, during the 1960s, which was the driving force behind the birth of the investment credit and attributed to its demise.

III. NEW ECONOMICS IN THE SERVICE OF FISCAL ACTIVISM

The first fifty years of the modern tax system witnessed tax policy applied in a traditional manner, focusing on revenue-raising goals to assist in the country's war efforts.[111] Until the Great Depression of the 1930s, orthodox fiscal policy called for annual budget-balancing. During wartime, tax policy was utilized to provide revenues to support the war efforts.[112] When conflicts were over, wartime taxes were scaled back, but still left at a high level.[113] After World War II, this policy was replaced by the concept of the "stabilizing budget," a policy that maintained a tax structure that would periodically be recalibrated to maintain a moderate surplus at high employment, with reliance on certain "built-in stabilizers" and monetary policy to combat ordinary recessions.[114]

At the end of the 1950s, the American economy was hampered by recessions and shortages of working capital, compounded by high interest rates and spiraling inflation.[115] In 1959, Congress initiated a wide-ranging examination of the ways by which the income tax structure increased inequities and the narrowing of the tax base.[116] These concerns developed into hearings held by the House Ways and Means Committee.[117]

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[109] *Id.*

[110] *Id.* ("Unlike the proposed credit, an initial allowance provision can be both simple and equitable in its application. A first step of this kind was adopted in this country in 1958 with the enactment of a limited first year depreciation allowance as section 179 of the Internal Revenue Code.").

[111] *See* Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685, 686 (1989) (citing a twelve-fold increase in federal budget expenditures from 1940 to 1945); *see also* W. Elliot Brownlee, *Tax Regimes, National Crisis, and State-Building*, *in* FUNDING THE MODERN AMERICAN STATE 1941–1995, at 93 (W. Elliot Brownlee ed., 1996); Lawrence A. Zelenak, *The Federal Retail Sales Tax that Wasn't: An Actual History and an Alternate History*, 73 LAW & CONTEMP. PROBS. 149, 177 (2010) (describing changes in tax policy that moved away from mass tax status).

[112] STEVEN A. BANK ET AL., THE PRICE OF CONFLICT: WAR, TAXES, AND THE POLITICS OF FISCAL CITIZENSHIP 10 (2008); JOHN F. WITTE, THE POLITICS AND THE DEVELOPMENT OF THE FEDERAL INCOME TAX 117–18 (1985).

[113] Surrey, *supra* note 17, at 477.

[114] Changes in the money supply were used moderately to influence interest rates and yields on corporate stock. GEORGE TERBORGH, THE NEW ECONOMICS 11–13 (1968).

[115] *See* Eyal-Cohen, *supra* note 11, at 53 (positing that small business favoritism was made possible by certain economic conditions and political elites).

[116] Surrey, *supra* note 17, at 480.

[117] *See generally 1961 House Hearings*, *supra* note 39.

The Kennedy administration assumed office in January 1961, in the midst of a recession, and sought ways to stimulate the economy.[118] The government embraced a new fiscal ideology by which it utilized the tax system to direct taxpayers' behavior to achieve social goals.[119] Fiscal policy was no longer aimed at budgetary balancing, but rather, a new era of furthering social and economic goals was underway. Paramount among tax measures was the Revenue Act of 1962, which added the investment credit and made important changes based on the New Economics theory.[120] The next subparts focus on the role the investment credit played in the transformation of tax policy from revenue-raising to furthering societal goals and economic stimulus. Eventually, this ambitious vocation turned out to be yet another nail in the investment credit's coffin.

A. *Compensatory Budget Policy*

The economic decline of the early 1960s was still underway and was expected to go further.[121] The administration's response was almost entirely to focus on the spending side of the budget, using executive orders to speed up federal disbursements, such as accelerating procurement

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[118] *See, e.g.*, *January 1962 Economic Report of the President: Hearings Before the J. Econ. Comm.*, 87th Cong. 2 (1962) (statement of Dr. Walter W. Heller, Chairman, Council of Economic Advisers) ("To provide stimulus and substance for the recovery, the administration early in 1961 took four steps: (1) successfully sought the cooperation of Congress in enacting legislation to expand purchasing power and create jobs; (2) accelerated Federal orders and payments on a wide front; (3) pursued policies to ease money and credit; and (4) followed generally an expansionary budget policy."); *see also Hearing on Revenue Act of 1962*, *supra* note 28, at 1456 (statement of James O. Fogleman, Vice President and Secretary, League of Louisiana Savings & Loan Association) (explaining the impact of the recession on the savings and loan industry in Louisiana); *id.* at 1624 (statement of Hon. Harry Flood Byrd, Chairman, Senate Finance Committee) (explaining the economic impact that the Revenue Act of 1962 might have on different industries); *State of the Economy and Policies for Full Employment: Hearings Before the J. Econ. Comm.*, 87th Cong. 115 (1962) [hereinafter *Hearings on Full Employment*] (statement of Dr. Walter W. Heller, Chairman, Council of Economic Advisers) (describing President Kennedy's policy and the public reaction to it); *Kennedy Readies Program to Curb Jobless Roll Rise*, WALL ST. J., Nov. 21, 1960, at 3 (announcing measures to create additional jobs).

[119] In addition, the administration's tax reform activity was not limited to revenue raising and the elimination of tax preferences, but began to focus on other considerations, such as eliminating unfairness. *See* SUSAN B. HANSEN, THE POLITICS OF TAXATION: REVENUE WITHOUT REPRESENTATION 105 (1983) (asserting that this shift in tax policy was a result of the will of "elected officials to maintain sufficient control over revenue and fiscal policy so as to be able to manipulate the economy and government spending for their own electoral benefit"); *see also* JOHN F. WITTE, THE POLITICS AND THE DEVELOPMENT OF THE FEDERAL INCOME TAX 117–18, 154 (1985); Brownlee, *supra* note 111, at 93; Jones, *supra* note 111, at 685–86 (highlighting that during World War II, the tax system underwent a shift in tax burden from a few top individuals to an overall revenue machine).

[120] Surrey, *supra* note 17, at 477 ("Each year has found the Congress engaged in the consideration of major tax legislation, and revenue measures of wide scope and important policy import have resulted.").

[121] TERBORGH, *supra* note 114, at 12.

placements, highway fund allocations, tax refunds, etc.[122] During the 1960s the situation escalated. Unemployment reached an economic mark of 4% growing to 7% in 1961, with a 1% inflation rate.[123] At the time, economic studies, such as that of Hall and Jorgenson, provided quantitative estimates of the short- and long-term consequences of various tax policies on the demand for investments in capital and equipment.[124]

President Kennedy decided to take things to the next level with New Economics theory. Backed by the Council of Economic Advisors, he proposed a new approach to put an end to the period of slow growth.[125] The President's Economic Report emphasized the need for the development of tax policies that would supplement monetary policy in assuring investment surplus.[126] The report mentioned that this was intended to be a step further in the art of fine-tuning.[127] The administration undertook a positive economic approach and acknowledged that a tax provision, such as expanded outlays on machinery and equipment, might be an efficient tool to achieve a particular stimulus objective.[128] For the first time, the government began to apply affirmative fiscal actions in the hope of attaining economic growth.[129] The administration's economic policy viewed it as appropriate to respond to recurring cycles of recession

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[122] *See* Surrey, *supra* note 17, at 481 ("The year 1961 marked the beginning of a concentrated attack on our balance of payments problems, an attack that has continued ever since.").

[123] *See* James Tobin, *Stabilization Policy Ten Years After*, BROOKINGS PAPERS ON ECON. ACTIVITY, no. 1, 1980, at 19, 58, 65; *see also Hearing on Revenue Act of 1962*, *supra* note 28, at 1456 (statement of James O. Fogleman, Vice President and Secretary, League of Louisiana Savings & Loan Association) (explaining the likelihood of a major mortgage crisis); *Hearings on Full Employment*, *supra* note 118, at 227 (statement of Rep. Curtis) ("I am afraid . . . [what you] call unemployment and unused capacity is part of a natural process of dealing with obsolescence."); *id.* at 234 (statement of Rep. Pechman) ("I am sure that when you have your hearings next February on the Economic Report you will find that unemployment is no lower than it is today.").

[124] Robert E. Hall & Dale W. Jorgenson, *Tax Policy and Investment Behavior*, 57 AM. ECON. REV. 391, 392 (1967); *see also* Seymour E. Harris, *Economic Fluctuations and Governmental Performance in the Sixties*, 12 UCLA L. REV. 1121, 1125 (1965) (indicating high levels of unemployment, an average of 52% for the years 1958–1964, as compared with 1% in 1944 and an average of 4% from 1947–1952).

[125] *See* ECONOMIC REPORT OF THE PRESIDENT 4 (1962), http://www.presidency.ucsb.edu/economic_reports/1962.pdf [https://perma.cc/GD89-NCJE]; ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS 39–40 (1962), http://www.presidency.ucsb.edu/economic_reports/1962.pdf [https://perma.cc/E3TE-5JQ3].

[126] ECONOMIC REPORT OF THE PRESIDENT, *supra* note 125, at 17.

[127] *Tax Changes for Shortrun Stabilization: Hearings Before the Subcomm. on Fiscal Policy of the J. Econ. Comm.*, 89th Cong. 64 (1966) [hereinafter *Tax Changes for Shortrun Stabilization*] (statement of Carl S. Shoup, Professor of Economics, Columbia University) (explaining the delicate economic balance between a tax on consumption and a tax on investment).

[128] ECONOMIC REPORT OF THE PRESIDENT, *supra* note 125, at 2.

[129] Surrey, *supra* note 17, at 478.

and recovery with expenditure increases as the weapon to end downslides.[130]

However, the basic idea of the New Economics philosophy utilized by the Kennedy administration was not new. The 1930s British economist J.M. Keynes[131] and his successors had long emphasized the need to control economic activity through manipulation of the federal budget position.[132] Unlike neoclassical economics that promoted the idea of free markets adjusted by an "invisible hand,"[133] Keynesian economic theory called for government intervention in the market to moderate cycles of economic activity.[134]

What the New Economics theory added was the belief in the *scope* of such control and the desire not just to balance but also to *spur* economic growth by increasing federal spending and reducing taxes, or to restrict

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[130] *See* SECRETARY OF THE TREASURY, DOC. NO. 3222, ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES 11 (1962) ("Although strong stimulation of the economy by fiscal means seemed no longer necessary, it was important to avoid a degree of restraint which might choke off the expansion needed to bring down unemployment and set the economy firmly on the road to sustained growth.").

[131] *See* JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 199 (Atl. Publishers 2008) (1936) ("'To dig holes in the ground,' paid for out of savings, will increase, not only employment, but the real national dividend of useful goods and services. It is not reasonable, however, that a sensible community should be content to remain dependent on such fortuitous and often wasteful mitigations when once we understand the influences upon which effective demand depends."); *see also* JOHN MAYNARD KEYNES: CRITICAL ASSESSMENTS 101–20 (John Cunningham Wood ed., 1994). *But see* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 37 (40th anniversary ed. 2002) (criticizing Keynes' ideas and advocating for competitive capitalism for economic and political freedom). *See generally* Howard S. Ellis, *The State of the "New Economics"*, 39 AM. ECON. REV. 465, 465 (1949) ("The general conclusions to be drawn from a newly published volume of essays on *The New Economics* seem to be that Keynes has influenced economic theory and policy as has no one else, living or dead; that much of his influence is beneficial; but that much, if indeed not most, of the theoretical innovations of the *General Theory* are acceptable only with extensive reservation or unacceptable as descriptions of reality.").

[132] *See, e.g.*, Franco Modigliani, *The Monetarist Controversy, or, Should We Forsake Stabilization Policies?*, *in* ESSENTIAL READINGS IN ECONOMICS 383 (Saul Estrin & Alan Marin eds., 1995) (stating that the stock of money has a major role in determining output and prices); J.R. Hicks, *Mr. Keynes and the "Classics;" A Suggested Interpretation*, 5 ECONOMETRICA 147, 148 (1937) (interpreting Keynes' theory as a "classical" theory); Abba P. Lerner, *Functional Finance and the Federal Debt*, 10 SOC. RES. 38, 38–39 (1943) (describing a government fiscal policy that focuses on the results of those actions on the economy); Abba P. Lerner, *The Essential Properties of Interest and Money*, 66 Q.J. ECON. 172, 192 (1952) ("Because of the absence of an *automatic* achievement of a satisfactory level of employment, monetary and fiscal measures must be harnessed to an employment *policy*."); Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 388 (1954) (explaining that government expenditure should be taken into account in economic calculations).

[133] *See, e.g.*, ADAM SMITH, THE WEALTH OF NATIONS: BOOKS I–III, at 157–66 (Andrew S. Skinner ed., Penguin Books 1986) (1776) (describing market conditions of natural commodity price).

[134] KEYNES, *supra* note 131, at 295 (discussing various conditions of overconsumption and underconsumption that balance between interest and money in the market).

economic activity by doing the opposite.[135] The New Economics doctrine called for utilizing fiscal,[136] monetary,[137] and expenditure policies in a flexible manner.[138] The objective of New Economics was to make appropriate changes on either or both sides of the federal budget using four primary characteristics: 1) federal activism, 2) growth orientation, 3) accurate forecasting, and 4) functional calibration.[139]

New Economics called for an active and flexible fiscal policy with a budget position revised as often as necessary.[140] The theory portrayed the tax system as in need of occasional "functional calibration," and assumed the correct position is the one that is correct for the given conditions, and cannot be standardized over time.[141] As opposed to other similar theories, New Economics was centered on the ever-rising potential of the economy.[142] It focused on gap-closing and development, as well as on utilizing statistical measures for the application of a growth-oriented approach.[143] For that purpose, the theory relied heavily on forecasting. The

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[135] *Id.*; *see also* ECONOMIC REPORT OF THE PRESIDENT, *supra* note 125, at 70 ("Federal expenditures and taxes affect total employment and production by influencing the total volume of spending for goods and services.").

[136] Increase in governmental expenditures was useful to stimulate the economy and decreased to stop inflation. ECONOMIC REPORT OF THE PRESIDENT, *supra* note 125, at 214; *see also* SEYMOUR E. HARRIS, THE ECONOMICS OF THE KENNEDY YEARS 88–97 (1964) (discussing federal expenditures as part of the New Economics policy).

[137] Monetary policy was used in a counter-cyclical manner by allowing greater credit in a lagged economy and restricting borrowing during inflation. ECONOMIC REPORT OF THE PRESIDENT, *supra* note 125, at 85; *see also* Harris, *supra* note 124, at 1122–23 ("An important contribution to investment was monetary expansion, a factor making for an excess of investment over saving—more money contributes to reduced interest rates, and hence there will be more investment."); David Meiselman, *The New Economics and Monetary Policy*, 23 FIN. ANALYSTS J. 95, 95–97 (1967) (discussing the effects of money and monetary policy on aggregate demand).

[138] Under this doctrine, in order to stimulate an economy, taxes can be reduced so as to spur consumer spending. During inflation, an increase in taxes was sought to have the effect of reducing spending. For a general overview of the "New Economics" doctrine, see *Hearings on the President's 1967 Tax Proposals*, *supra* note 22, at 518–24 (statement of Joseph A. Pechman, Director of Economic Studies, Brookings Institution).

[139] *Id.*

[140] TERBORGH, *supra* note 114, at 8. In this book, George Terborgh, an economist at the Machinery and Allied Products Institute and Council for Technological Advancement, describes the essence of the New Economics theory from a critical point of view.

[141] *Id.* at 23; *see also* Alvin H. Hansen, *Inflation and the New Economics*, CHALLENGE, Nov./Dec. 1966, at 4, 6 (contending that monetary policy should always be relegated to the position of serving as a "handmaiden to fiscal policy" and has the capacity of playing an enormously important role).

[142] Walter W. Heller, Address at Committee on Economic Development Symposium: Adjusting the "New Economics" to High-Pressure Prosperity (May 1966), *reprinted in* MANAGING A FULL EMPLOYMENT ECONOMY 8, 9 (1966) ("[New Economics] is a commitment to an active, positive, and continuous use of the instruments of modern economics to help keep demand at levels that will make full use of the economy's potential—and keep that potential growing—without inflation.").

[143] For example, since New Economics set as its goal the maintenance of economic activity at the "full employment" level, it compiled a series of estimates of potential gross national product (GNP) that would be created at a four percent unemployment rate from which it subtracted the actual GNP to

annual budget began to incorporate an average forecasting lead of twelve months.[144] The incorporation of statistics and scientific calculations into predictions allowed economists of the Council of Economic Advisors to feel confident and optimistic about their ability to foresee market changes and react accordingly.[145]

However, critics of the New Economics theory dismissed its effectiveness as counteractive, or contracyclical, fiscal theory.[146] They believed the theory had several fundamental problems.[147] At the outset, economic forecasts were said to be speculative, inaccurate, and lengthy.[148] There were three time lags involved in taking tax action: the time it takes to interpret statistical and economic data and officially recognize and acknowledge the need for action (recognition lag), which can further lag for political reasons;[149] the time required to obtain Congress's approval after such recognition (legislative lag);[150] and once a tax measure is enacted, there is a further lag in the response of the economy to that

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derive the "GNP gap." It then utilized fiscal policy to eliminate that gap. TERBORGH, *supra* note 114, at 20.

[144] *Id.* at 22 (arguing that because of the time lag between the initiation of such adjustments and the realization of their economic effects, the adjustments must also be based on forecasts for shorter periods than the regular budget).

[145] SUBCOMM. ON FISCAL POLICY, J. ECON. COMM., 90TH CONG., 2 REVENUE SHARING AND ITS ALTERNATIVES: WHAT FUTURE FOR FISCAL FEDERALISM? 1205, 1207–08 (Comm. Print 1967); TERBORGH, *supra* note 114, at 22 ("Our statistical net is now spread wider and brings in its catch faster. Forecasting has the benefit of not only more refined, computer-assisted methods, but of improved surveys of consumer and investment intentions.").

[146] Harris, *supra* note 124, at 1128–29 ("On reasonable assumptions, I estimate that it costs roughly from five to ten times as much to create a job through the deficit route (*e.g.*, by tax cut) as through the Manpower Training Act, that is, by training an unemployed worker for a new job."); *see also* Richard D. Hobbet, *Transitional Mechanisms to Facilitate Tax Reform*, 34 LAW & CONTEMP. PROBS. 818, 821 (1969) ("The enactment of the rate reductions in the 1964 Revenue Act has been characterized by Professor Surrey as a watershed in tax policy history, swinging the country over to the 'new economics.'"); Robert E. Lucas, Jr., *An Econometric Policy Evaluation: A Critique*, 70 J. MONETARY ECON. 19, 30 (1973) (arguing that econometric estimates are concerned with the timing aspects of this form of fiscal action and that if the fiscal action is eventually accomplished, it is subject to all of the lags and affecting tax changes *believed* to be permanent by taxpaying corporations).

[147] Mortimer M. Caplin, *Federal Tax Policy—The Need for Reform*, 56 GEO. L.J. 880, 895 (1968) ("Recent developments, however, indicate less enthusiasm for this school of thought [New Economics] when the call is for economic restraint and increased taxes."); Leo J. Raskind, *The Federal Reserve System: An Administrative Agency for Contemporary Monetary Policy?*, 35 GEO. WASH. L. REV. 299, 313 (1967) ("Whether we are in a 'new era' or merely under the influence of the 'new economics' may be open to some dispute.").

[148] TERBORGH, *supra* note 114, at 21–22, 97 (arguing that the average forecasting lead time is twelve months, far beyond the effective range of the CEA and, even if the budget were enacted as substantially as proposed, this long lead time would itself preclude any semblance of precise fiscal action).

[149] *Id.* at 96. For example, the Administration will be reluctant to admit to a recession until forced by a period of consistent data.

[150] *Id.* at 106. One way to alleviate this lag is through presidential executive spending action.

action.[151] According to the Treasury, these time lags took between nine and twelve months.[152] The Commerce Department and National Industrial Conference Board estimated an even longer lag.[153] Assistant Treasury Secretary Stanley Surrey was more pessimistic, professing that it takes two to four quarters for any significant impact to take place,[154] while leading economist Joseph Pechman anticipated a lag of six to twelve months before changes in consumer spending are witnessed.[155]

Finally, critics such as economist Robert Lucas contended that once a desired fiscal action is chosen, determining the magnitude of such action was purely speculative and subject to various biases.[156] The new predictions were based on an assumption of permanency—which was not the case of the investment credit.[157] Lucas concluded that short-term forecasting does not necessarily attest to the actual consequences of alternative economic policies.[158] It entailed assessing what would be the course of the economy in the absence of fiscal action, by how much the action should attempt to deflect it from its course, and what dosage is needed to accomplish the change.[159] Rather than being self-evident, the

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[151] *See id.* at 98 ("The lag of demand is likely to be particularly marked in the case of business taxpayers operating against long-term plans."); Meiselman, *supra* note 137, at 97 ("It turns out that, after a lag, the change in the demand for credit swamps the change in the supply of credit stemming from the initial increase in the money supply.").

[152] 113 CONG. REC. 6900 (1967) (statement of Rep. Bell) (stating that the Department of the Treasury estimated the average order-to-completion period for equipment eligible for investment credit as nine to twelve months, excluding buildings and structures, for which the period is much longer).

[153] *See* NAT'L INDUS. CONFERENCE BD., SURVEY OF CAPITAL APPROPRIATIONS 303 tbl.2 (1967); Genevieve B. Wimsatt, *Business Investment and Sales Expectations for 1967*, SURV. CURRENT BUS., Mar. 1967, at 8, 9 (explaining that the average lag between new investment decisions and expenditures spans several quarters).

[154] *See Tax Changes for Shortrun Stabilization*, *supra* note 127, at 238 (statement of Stanley S. Surrey, Assistant Secretary of the Treasury) (claiming that the impact on the annual rate of GNP ranged between $1–$2 billion per $1 billion of change in individual tax liability); *see also* J. Clifton Fleming, Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437, 497 n.194 (2008) (noting Surrey considered an investment tax credit to be an expensive tax expenditure); Bert G. Hickman, *Diffusion, Acceleration, and Business Cycles*, 49 AM. ECON. REV. 535, 540 (1959) (discussing investment lags and expansion gaps).

[155] *Hearings on the President's 1967 Tax Proposals*, *supra* note 22, at 598 (statement of Joseph A. Pechman, Director of Economic Studies, Brookings Institution); *see also Tax Changes for Shortrun Stabilization*, *supra* note 127, at 10 (statement of E. Cary Brown, Professor of Economics, Massachusetts Institute of Technology) (stating that a low estimate of witnessing the effects on change in consumer spending would be two quarters).

[156] Lucas, *supra* note 146, at 20; *see also* Meiselman, *supra* note 137, at 100 ("My own judgment is that much of the content of the more recent set of policy proposals which require more knowledge than we possess—and aim to achieve ends of dubious merit—are no less erroneous than the New Economics' first set of policy proposals which denied any important role at all to money.").

[157] Lucas, *supra* note 146, at 30.

[158] *Id.* at 85.

[159] TERBORGH, *supra* note 114, at 108.

determination of dosage was said to be cloudy and uncertain.[160] Yet, despite its critics, New Economics enjoyed initial political support.[161] Fending off critics of the New Economics theory, leading economist and former chairman of the CEA Walter Heller noted:

> [G]overnment action to stimulate supply and suppress demand at certain pressure points in the economy might well pass the test of economic efficiency. In pursuing these questions and hypotheses, the economist will be laying a firmer conceptual and empirical foundation for specifying the areas and circumstances in which intervention may be the lesser evil.[162]

As the next subpart demonstrates, intense foreign competition and the need for balance of payments were ripe political conditions for the New Economics doctrine and the investment credit as its test case.

B. *Foreign Competition and the Economic Race*

During the 1960s, economic growth had become the primary objective of the government for political and strategic reasons, arising from balance-of-payments considerations and an "economic race" with the Soviet Bloc.[163] The U.S. government became concerned with its economic growth rate, which had fallen behind the Soviet Union, Japan, and Western Europe.[164] Many foreign nations were subsidizing investments and allowing a more rapid cost recovery of new plants and equipment, in order

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[160] *See, e.g.*, *id.* at 184; Alfred G. Buehler, *The Problem of Inflation*, 326 ANNALS AM. ACAD. POL. & SOC. SCI. 1, 7 (1959) ("We have not yet learned how to iron out the general fluctuations in the economy which we call business cycles.").

[161] *See, e.g.*, J.B. Condliffe, *The Guideline Economy*, 35 GEO. WASH. L. REV. 253, 273 (1966) ("The new economics produced striking results as long as it was possible to mobilize reserves of unemployed labor and unused industrial capacity."); Charles S. Overmiller, *The Economic Outlook and Tax Policy*, 20 TAX EXECUTIVE 213, 214 (1968) ("This impressive record of economic growth and the concurrent use of a stimulative taxing and spending policy lend support to the argument that the 'new economics' can be used effectively in moving the economy from a period of economic slack to full utilization of its resources.").

[162] Walter W. Heller, *What's Right with Economics?*, 65 AM. ECON. REV. 1, 24 (1975).

[163] *See* Abram Bergson, *The Great Economic Race: U.S.A. vs. U.S.S.R.*, CHALLENGE, Mar. 1963, at 4, 4 ("There are many Cassandras who argue that unless the United States increases its growth rate substantially, the Soviet Union will soon replace us as the world's first industrial power."); Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle to Allocate Income for Cross Border Taxation*, 21 MICH. J. INT'L L. 143, 154 (2000) (describing the growing government concern in the 1960s of tax avoidance by U.S. corporations using transfer pricing strategies with affiliates in low or no tax jurisdictions).

[164] *See* Solomon Fabricant, Interview, *The Science and Art of Economic Growth*, CHALLENGE, Feb. 1961, at 22, 25 (acknowledging that "[p]eople have been worried about our relative position in the world in respect to growth").

to compete with other foreign industries.[165] There was a growing consensus in politics, industry, and academia on the necessity to provide the equivalent of these foreign investment incentives to spur large-scale capital investments. For example, the U.S. Chamber of Commerce emphasized that price and wage scales were not economically efficient compared to those offered abroad.[166] Scholars called for the lowering of the corporate tax rate, claiming that higher tax burdens put U.S. firms at a disadvantage for expansion and domestic production compared to their foreign competitors.[167]

There was a general belief that the United States had been unable to do a great deal with provisional and restricted incentives, such as the immediate expensing rule, in ensuring the modernization and replacement of productive facilities that were then greatly needed.[168] Business leaders, such as the President of General Electric, warned that capital formation and economic growth in the United States during the 1950s were lower than ever:

> Adding urgency to this task of modernizing our manufacturing plants is the newly-intensified challenge of world competition. . . . But, Cold War aside, the realities of competition in today's world markets demand that we modernize those main aspects of public policy which affect economic growth. In such a re-examination, tax reform must come near the top of the agenda.[169]

Professionals emphasized that compared to other nations, U.S. industry suffered from inefficiency and a lack of modernized production

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[165] *See, e.g.*, Richard N. Cooper, *National Economic Policy in an Interdependent World Economy*, 76 YALE L.J. 1273, 1287–88 (1967) (surveying the investment incentives granted by leading nations at the time, including the United Kingdom, Germany, Belgium, Japan, etc.).

[166] *See 1961 House Hearings*, *supra* note 39, at 987 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) (explaining that the United States has labor capacity but that it is very costly compared to foreign countries that have more modern facilities).

[167] *See, e.g.*, *Hearing on Revenue Act of 1962*, *supra* note 28, at 3089–90 (statement of Dan Throop Smith, Professor of Economics, Harvard University) (advocating for providing American business firms with lower domestic income tax rates in order to compete with foreign companies abroad).

[168] *See, e.g.*, *President's Proposal to Repeal Investment Tax Credit and to Extend Tax Surcharge and Certain Excise Tax Rates: Public Hearing on H.R. 12290 Before the H. Comm. on Ways & Means*, 91st Cong. 187–89 (1969) [hereinafter *President's Proposal to Repeal Investment Tax Credit*] (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) (explaining the various shortcomings of the current tax investment credit incentive); William F. Butler, Interview, *Problems in the U.S. Economy*, CHALLENGE, Jan. 1962, at 20, 21 (examining U.S. economic growth problems).

[169] Gerald L. Phillippe, *Taxes and Economic Growth*, 14 TAX EXECUTIVE 302, 304–05 (1962).

methods.[170] Many foreign plants were newer and more modern than their U.S. counterparts, which put American industry in an inferior competitive position and intensified the nation's balance-of-payments problem.[171]

These concerns played an important role in the government's decision to inaugurate the investment credit.[172] In 1962, Treasury Secretary C. Douglas Dillon testified in favor of enacting the investment credit as a tool to solve the balance-of-payments deficit, stating "[i]t is essential to our competitive position in markets, both here, at home, and abroad, that American industry be put on the same basis as foreign industry. Unless this is done, increased imports and decreased exports will unnecessarily add to the burden of our balance-of-payments deficit."[173]

Under the leadership of its Chairman, Walter Heller, the Council of Economic Advisors (CEA) launched one of its most effective public campaigns.[174] In the following years, New Economics became a dominant government philosophy of fiscal planning and action. Following the CEA's recommendation, Congress enacted the investment credit in the hope of encouraging equipment and machinery purchase through an increase in their rate of return and cash flow from their investment.[175] Yet, from its

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[170] *See* Martin Chancey, *The Relative Decline of the United States Economy*, 26 SCI. & SOC'Y 385, 387 (1962) (providing a comparative outlook on production in the United States and other industrial countries); John W. Cook, *The Investment Credit: Investment Incentive and Countercyclical Tool*, 45 TAXES 227, 230 (1967) (positing investment in modern production facilities was one of the best remedies to improve production rates).

[171] *See* Butler, *supra* note 168, at 21 ("Even more important . . . is the need for more rapid modernization of our plant and equipment. . . . To insure a vigorous and growing economy, we must reduce the average age of our plant and equipment."); Cook, *supra* note 170, at 230 (explaining that the lack of modernized production facilities contributed to inefficient production rates in the United States).

[172] *See* Cooper, *supra* note 165, at 1287–88 (detailing international tax incentive policies used to encourage investment in new plants and equipment).

[173] *Hearing on Revenue Act of 1962*, *supra* note 28, at 83 (statement of Douglas Dillon, Secretary of the Treasury).

[174] *See, e.g.*, *January 1961 Economic Report of the President and the Economic Situation and Outlook: Hearings Before the J. Econ. Comm.*, 87th Cong. 310 (1961) (statement of Walter W. Heller, Kermit Gordon, and James Tobin, Council of Economic Advisers); Arthur F. Burns, Professor, Columbia University, Address Before the Business Economists Conference of the University of Chicago: Examining the New "Stagnation" Theory (Apr. 21, 1961), *in* THE MORGAN GUARANTY SURVEY, May 1961, at 4 (examining the impact of the Federal government's monetary policy on the recession between 1958 and 1960); Council of Economic Advisors, *The Council's View*, *in* THE MORGAN GUARANTY SURVEY, Aug. 1961, at 1 (comparing and contrasting Dr. Burns' analysis of the economic factors impacting the economy between 1958 and 1960 with that of the Council's); Arthur F. Burns, *A Second Look at the Council's Economic Theory*, *in* THE MORGAN GUARANTY SURVEY, Aug. 1961, at 6; *see also* Boris P. Pesek, *Growth, Capacity Output, and the Output Gap*, 45 REV. ECON. & STAT. 294, 294 (1963) ("Last spring and summer we witnessed a vigorous exchange of views between the present Council of Economic Advisors to the President and the former chairman of that body, Professor Arthur F. Burns.").

[175] *See January 1963 Economic Report of the President: Hearing on Sec. 5(a) of Pub. Law 304 Before the J. Econ. Comm.*, 88th Cong. 26 (1963) (statement of Walter W. Heller, Chairman, Council of Economic Advisors) (describing a sharp decline in output from 1958 to 1962); Surrey, *supra* note

inception, the investment credit attracted much criticism. The next Part demonstrates that although the declared policy of the administration was not to use the new credit as a cyclical device, but to make it permanent,[176] reality reflected the contrary. Businessmen were skeptical of the administration's aversion to an on-again-off-again investment credit.[177] This cyclical instrumentalism eventually led to the demise of the investment credit.

IV. CYCLICAL FISCAL ACTIVISM IN FORCE

A. *The Business Community's Disapproval*

In 1962, McGraw-Hill conducted a survey to predict future capital expenditures as a result of utilizing the investment credit.[178] Businessmen responded that it would only raise their capital expenditure by one percent.[179] Nine out of every ten companies that participated in the survey replied they did not anticipate making any use of the tax credit.[180] That same year, the National Industrial Conference Board conducted a similar survey of the largest manufacturing corporations to determine the effect of the tax credit upon capital investment trends.[181] Here, too, the survey reported a rather small expected increase in capital outlay; in the majority of the industries, the anticipated increase was under one percent.[182] A separate survey provided an even gloomier picture.[183] The majority of firms in that study indicated they did not expect the new tax credit to have any influence on their capital investment decisions.[184]

17, at 477–78.

[176] *See Hearing on Revenue Act of 1962*, *supra* note 28, at 2912 (statement of John L. Connolly, Chairman, Federal Finance Committee, Council of State Chambers of Commerce) ("Well, it is intended to be permanent, I am confident of that."); Cook, *supra* note 170, at 227 (holding both the accelerated depreciation and the investment credit as instituted as permanent parts of the tax code).

[177] Kraus, *supra* note 1, at 61.

[178] *See* Supplemental and Minority Views of Sens. Paul Douglas & Albert Gore, 1962-3 C.B. 1092, 1100 (critiquing the benefit of providing investment credits on gross rather than marginal net investments).

[179] *Id.* (amounting to $300 million in 1962).

[180] *Id.*

[181] Nat'l Indus. Conference Bd., *Special Survey on Pending Tax Litigation*, BUS. REC., July 1962, at 19.

[182] *Id.*

[183] F.O. Woodard & Vincent M. Panichi, *Investment Influences of the Tax Credit Program*, 18 NAT'L TAX J. 272, 272–73, 275–76 (1965) (stating out of forty-two firms surveyed only four indicated the credit exerted some influence over their decision); *see also Capital Gains Tax Bills: Hearings on S. 2428, S. 2608, & S. 3065 Before the Subcomm. on Taxation & Debt Mgmt. of the S. Comm. on Fin.*, 95th Cong. 64 (1978) (describing results of several other surveys similar to McGraw-Hill).

[184] Woodard & Panichi, *supra* note 183, at 276 ("What effect will the 1964 amendment have on investment? If the results of this present study can be considered valid, the answer is very little.").

The temporary character of the new tax credit, and its declared purpose of countering economic cycles, had businessmen up in arms. Business executives remained apprehensive regarding the abundant uncertainty in the President's declaration that "it may prove desirable for the Congress to modify the credit from time to time so as to adapt it."[185] They sought certainty.[186] The National Association of Manufacturers considered the new credit as a device intended for the manipulation and control of the U.S. economy.[187]

Professionals, scholars, and the media described the investment credit as "sugar coating,"[188] a "gimmick,"[189] and an "outright gift" to its intended beneficiaries.[190] The Rubber Manufacturers Association labeled it an "unwanted subsidy," arguing that it was a major departure from general tax principles and an unjustified appropriation.[191] The American Federation of Labor and the Congress of Industrial Organizations referred to the investment credit as a "multibillion-dollar windfall that will not really contribute anything to our national goals."[192]

The business community was in turmoil.[193] In its recommendation to the President, the Chamber of Commerce argued that the new tax credit

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[185] H.R. DOC. NO. 140, at 6 (1961).

[186] *See, e.g.*, J.A. Livingston, *Business Outlook . . .: Investment Tax Credit Just 'Another Loophole'*, WASH. POST, Jan. 5, 1962, at B9 (arguing for a simpler tax structure by citing the increasing positions of prominence tax considerations now occupy in the course of business decisions); Lee Silberman, *Officials of 8 Big Accounting Firms Split Over Treatment of Investment Tax Credit*, WALL ST. J., Dec. 18, 1962, at 32 (describing the even split amongst the members of the Accounting Principles Board with regard to accounting for the tax rule); *Utility Head Asks Rise in Tax Credit: Action to Spur Investment Is Urged in Senate Inquiry*, N.Y. TIMES, Apr. 10, 1962, at 26 (explaining how the uncertainty about the tax credit has a depressing effect upon low margin business such as hotels).

[187] *1961 House Hearings*, *supra* note 39, at 1374–75 (statement of Charles R. Sligh, Jr., Executive Vice President, National Association of Manufacturers).

[188] Daniel C. Knickerbocker, Jr., *The New Investment Tax Credit*, PRAC. LAW., Dec. 1962, at 43, 43 ("The sugar coating on the President's 1961 tax proposals was the so-called 'investment credit' . . . .").

[189] *1961 House Hearings*, *supra* note 39, at 1023 (citing a Business Week article calling the investment credit a gimmick).

[190] *A.D.A. Asks Kennedy to Reject Tax Bill*, N.Y. TIMES, Oct. 4, 1962, at 22 (stating the bill will not stimulate the economy and will cause a substantial decrease in tax revenue).

[191] *1961 House Hearings*, *supra* note 39, at 1550 (statement of Rubber Manufacturers Association, Inc.).

[192] S. REP. NO. 87-1881, at 348 (1962) (statement of Stanley H. Ruttenberg, Director of Research, AFL-CIO).

[193] *See 1961 House Hearings*, *supra* note 39, at 2905 (statement of John L. Connolly, Chairman, Federal Finance Committee, Council of State Chambers of Commerce) ("As a tax reduction provision, the investment credit is discriminatory."); J.A. Livingston, *Business Outlook: No Great Loss if Tax Bill Loses*, WASH. POST, Sept. 12, 1962, at B8 ("The only excuse for the bill is the President's ardor for the investment tax credit, based on the dubious speculation that it will speed the nation's industrial growth."); Richard VanderVeld, *Industry Cautious over Depreciation Move*, L.A. TIMES, July 13, 1962, at C10 ("There seems to be a misunderstanding what this means in the eyes of many people. . . . [F]aster credit in early years would be offset by higher taxes in later years after writeoffs had been

was unfair and unreasonably discriminatory between taxpayers within the business community in certain industries.[194] Additionally, it claimed the credit would not provide a sufficient stimulus to businesses that were in the position of making large investments.[195] The Chamber's representative argued that the new credit also discriminated against small and marginal businesses because it applied only to firms with positive tax liability, which the credit could offset.[196] Instead, it proposed an overall liberalization of the tax depreciation allowance system and immediate expensing by eliminating the maximum limitation on the initial first-year allowance altogether.[197]

For similar reasons, the small-business lobby also expressed its disapproval of the investment credit.[198] It considered the credit a mechanism aimed at larger businesses that were already capable of expansion.[199] Small businessmen claimed that the new credit would not encourage their expansion, especially because it initially applied only to new property, which they could not often afford, compared to newly acquired, used property.[200] They argued that instead of enacting a new apparatus, "[i]t would be far better to liberalize the treatment of depreciation and work toward a general reduction in income tax rates."[201] In order for them to utilize the tax credit, they required strong borrowing

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completed.").

[194] *1961 House Hearings*, *supra* note 39, at 992 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce) ("The tax credit is unfairly discriminatory, because it gives preferential tax treatment to one particular segment of the business community. . . . the segment that happens to be in a position to make unusually large investments in 1961.").

[195] *Id.* at 993 ("If there is to be a tax credit subsidy for investment in productive facilities, it seems to me it should be given to all taxpayers in proportion to their investment in productive facilities.").

[196] *See id.* at 1033 (statement of Rev. William T. Hogan, S.J.) ("Marginal firms in large industries will probably not get the full advantage of the plan and this is unfortunate for they need it most."); *see also Hearing on Revenue Act of 1962*, *supra* note 28, at 468 (statement of Walter A. Slowinski, U.S. Chamber of Commerce) ("The credit gives preferential tax treatment to certain taxpayers in favored groups. It may actually be a windfall to a business which had already fortuitously planned to purchase new facilities later in 1962. On the other hand it will work against small businesses . . . .").

[197] The Chamber of Commerce thought the new credit an insufficient stimulus to offset the effect of the denial of capital gain treatment at a time of disposition of depreciable assets. *1961 House Hearings*, *supra* note 39, at 986 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce).

[198] *Id.* at 1553–54 (statement of Henry J. Griswold, Chairman, Tax Committee, Smaller Business Association of New England).

[199] *Id.* at 1554.

[200] Many small businesses purchased refurbished or used property. *Id.* Others that did not have access to loans and outside funding used lease financing in order to obtain capital equipment. *Id.* at 1581 (statement of Alvin Zises, President, Bankers Leasing Corp.).

[201] S. REP. NO. 87-1881, at 349 (1962) (statement of Charles B. Shuman, President, American Farm Bureau Federation).

power and positive tax liability.[202] Businesses with losses or negative tax liability could not utilize the investment credit, but could carry it forward to a year where they incur a positive tax balance.[203]

Political organizations, such as Americans for Democratic Action—one of the nation's oldest liberal groups[204]—also advocated against the new tax credit and for expansion of immediate expensing.[205] They urged the Ways and Means Committee to commit to liberalizing the depreciation system.[206] They acknowledged that tax incentives were needed to encourage investors to assume risks, to develop new undertakings, and to expand existing businesses.[207] Although some regarded the investment credit as nothing more than a temporary transitional measure,[208] others recognized that, once enacted, tax preferences are hard to discontinue.[209]

Many considered the investment credit to be a big business tax break because it was made available not only to individuals and ordinary corporations, but also to large mutual savings banks, regulated investment companies, real estate investment trusts, and other organizations.[210] Accordingly, representatives from large firms, such as Honeywell Co., admitted that, although their firm would probably benefit from the new investment credit, it would not be used by companies that most needed it to make possible the expansion and rehabilitation of their equipment.[211] The president of General Electric added, "With respect to the specifics of the investment credit plan, however, I do not think it can go unnoticed that

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[202] *Id.*; *see also* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 311 n.4 (1972) (noting that the benefit of the investment tax credit is confined to those having a positive tax liability).

[203] William A. Klein, *Some Basic Problems of Negative Income Taxation*, 1966 WIS. L. REV. 776, 784.

[204] *Internship Opportunities: About ADA*, AMERICANS FOR DEMOCRATIC ACTION, http://www.adaction.org/pages/about/intern-at-ada.php [https://perma.cc/UDW6-QL2A] (last visited Oct. 16, 2015).

[205] *1961 House Hearings*, *supra* note 39, at 1008–09 (statement of Robert R. Nathan, Vice Chairman, Americans for Democratic Action).

[206] *Id.* at 1009.

[207] *Id.* at 1007 ("[I]f tax incentives are made more and more attractive, investors will put more and more money into new plants and equipment.").

[208] *See infra* notes 248–49, 258 and accompanying text.

[209] *Hearing on Revenue Act of 1962*, *supra* note 28, at 2912 (statement of Harry Flood Byrd, Chairman, Senate Finance Committee) ("When you start a subsidy, it is hard to stop it. We don't stop subsidies."); *President's Proposal to Repeal Investment Tax Credit*, *supra* note 168, at 187–90 (statement of Rep. Edward Garmatz).

[210] *See* J.M. Walters, *Recent Developments in the Federal Income Tax Laws—A Selective Survey of Recent Legislative and Administrative Developments*, 41 N.C. L. REV. 745, 748 (1963) (indicating that special rules apply to mutual savings banks, cooperative banks, domestic building and loan associations, regulated investment companies, and real estate trusts when utilizing the investment credit).

[211] *1961 House Hearings*, *supra* note 39, at 1582 (statement of Paul B. Wishart, President, Minneapolis-Honeywell Regulator Co.).

most business executives have shown a distinct lack of enthusiasm."[212] He, too, saw a sign of change in Washington, and hoped for placing a higher priority on capital formation and modernization through larger expensing.[213]

Nevertheless, over time, some in the skeptical business community began to support investment in machinery and equipment.[214] This shift was manifested soon after the investment credit's debut, when an unprecedented demand for machinery and equipment exceeded the nation's capacity to produce such goods.[215] Businessmen began to realize the potential of the investment credit in providing a hefty tax break against their tax bill. As a result, the government used the investment credit in various ways to react to the changing economic conditions.[216] But prior to that undertaking, the next subpart illustrates another disadvantage of the investment credit that contributed to its repeal—its complex nature.

B. *Complex Administration*

Some members of business groups rejected the investment credit for being too convoluted and difficult to administer.[217] Small business incumbents, such as the House and Senate Select Committees on Small Business, used the investment credit's complex nature in their attempts to persuade Congress to enact straightforward tax measures geared toward small business.[218] They argued that the immediate expensing rule was a better alternative, as it was simpler and easier to administer.[219] Instead of

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[212] Phillippe, *supra* note 169, at 307.

[213] *See id.* ("The objective which the proposed investment credit is said to serve is precisely right. Like some of these other suggestions I have mentioned, it is directed at meeting the important need for correcting the climate for capital formation and modernization.").

[214] Surrey, *supra* note 17, at 478.

[215] *See* BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 1962, at 484 (1962) (depicting the gradual increase in business expenditure in the areas of manufacturing and mining equipment and communication, commercial, and miscellaneous); BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 1963, at 487 (1963) [hereinafter 1963 STATISTICAL ABSTRACT] (displaying the further increase in business expenditure between the years 1962 and 1963 in relation to manufacturing and mining equipment as well as communication, commercial, and miscellaneous items); *see also* Heller, *supra* note 142, at 15 ("The longer-range economic prospect is reassuring, even inviting. But right now, we find ourselves in the turbulent waters of high-pressure prosperity.").

[216] 1963 STATISTICAL ABSTRACT, *supra* note 215, at 487.

[217] *1961 House Hearings*, *supra* note 39, at 986–87 (statement of Joel Barlow, Member, Taxation Committee of U.S. Chamber of Commerce); *Hearing on Revenue Act of 1962*, *supra* note 28, at 468 (statement of Walter A. Slowinski, U.S. Chamber of Commerce).

[218] *1961 House Hearings*, *supra* note 39, at 1554 (statement of Henry J. Griswold, Chairman, Taxation Committee, Smaller Business Association of New England) ("[T]o assist small business must provide a realistic means of enabling smaller enterprises to retain a larger proportion of before-tax earnings.").

[219] *Id.* at 1537 (statement of Clyde McFarlin, U.S. Independent Telephone Associations, and John Clark, President, International Union of Mine, Mill & Smelter Workers).

keeping a record of depreciation deductions over years, immediate expensing allowed a write-off of the investment in the first year it was placed in service.[220] Accordingly, the SBA and the small business congressional committees advocated for the expansion of immediate expensing limits to enable small businesses to retain and utilize pre-tax earnings.[221] They mentioned that the investment credit added various complexities when applied to pass-through entities, and thus proposed to make it more small business friendly.[222]

The investment credit had various limitations and exclusions, exclusions within these exclusions, and different rates under different conditions.[223] The recapture of the credit in the case of certain dispositions, and many other provisions, made it impossible to comprehend and administer.[224] The Treasury did not provide clear guidance for many of these intricacies.[225] To illustrate just one complexity, the carryovers and carrybacks rule of the unused portion of the credit was so convoluted that professionals testified that any 1962 unused credit could affect tax returns all the way through to 1973.[226] For example, one of the investment credit's problems was its initial basis adjustment provision, also known as the "Long Amendment."[227] Any unused amount of credit could lower the tax

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[220] SETO, *supra* note 37, at 235.

[221] *Id.*

[222] Jay W. Glasmann, *Investment Credit—One Year Later*, 1964 PROC. ANN. TUL. TAX INST. 385, 405 (emphasizing the added complexities through an example of the intricacies that come into play in making the selection of assets eligible for the credit under used property rules); *see also* I.R.C. § 48(b)–(c) (1964) (providing special rules for seven years of carryover and carryback to tax year 1961 of unused credits if the amount exceeds certain limitation in subsection (a)(2) and carryover to nine and ten years to subsequent excess).

[223] *1961 House Hearings*, *supra* note 39, at 22–23 (statement of Douglas Dillon, Secretary of the Treasury); *see also* 108 CONG. REC 17,749 (1962) (remarks of Sen. Kerr) (discussing the investment credit generally, including the types of property included in qualified investment and thus eligible for the investment credit).

[224] J.W. Baldwin, *Investment Credit Problems of the Oil and Gas Industry*, 1964 PROC. ANN. TUL. TAX INST. 429, 430.

[225] *Id.*; *see also* Shirley v. Comm'r, T.C.M. (RIA) 2004-188, 2004 WL 1879831, at *2 (finding the long historical tax litigation of the investment credit usable precedent in administrating other investment property tax cases).

[226] After the restoration of the credit, it was even more difficult to calculate the amount of the credit. *See Hearing on Revenue Act of 1962*, *supra* note 28, at 3018 (statement of D. Nelson Adams, Chairman, Tax Committee, New York City Bar Association); 1967-34 I.R.B. 531 (noting computation of the credit for taxable years beginning in 1966 and ending March 9, 1967 as well as for years beginning in 1966 and ending in the suspension period).

[227] Initially, the investment tax credit provisions as enacted in 1962 required reduction of the depreciable tax base of any qualified property in an amount equal to the credit. Revenue Act of 1962, Pub. L. No. 87-834, § 2(b), 76 Stat. 960, 970 (repealed 1964). Adoption of this requirement in an amendment proposed by Senator Russell Long reflected concern over the revenue cost of the credit. *See* S. REP. NO. 87-1881, at 19 (1962) (addressing the seven percent cost reduction of property and the circumstances under which this amount is inappropriate as it is too large); *see also* Leslie M. Rapp, *Pensions for the Self-Employed: The Treasury Department-Finance Committee Plan*, 16 TAX L. REV.

payable in earlier or later years by means of carrybacks and carryovers, but contained many limitations and intricate rules.[228] Other problems were found in determining the useful life and time that the property was placed in service.[229] The new credit restricted the type of property in which the investment must be made and the amount of tax liability for the year that could be offset by the credit.[230] In addition, corresponding sections were added to reduce the amount of the credit, according to the useful life of such property.[231]

Accordingly, many leaders[232]—of industry associations,[233] unions, and labor organizations[234]—claimed that the varying percentage schedules made the investment credit too complicated. Business executives from large companies, such as the Edison Electric Institute, warned of the tax credit's overly complex administration.[235] In his article on the 1962 tax reform, the President of General Electric commented that the new device is "overloaded with special features and dispensations."[236] Professionals opined that the new investment credit was terribly complex and, in many

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227, 249 (1960) ("Perhaps of equal significance was the Senator's statement that he would accept and co-sponsor the Long amendment . . . ."). In 1964, Congress repealed the basis adjustment feature, thus significantly liberalizing the credit and greatly increasing its value. *See, e.g.*, *'64 Investment Credit Claim Was $1.3 Billion*, WASH. POST, Aug 30, 1967, at C9 ("A total investment credit of $1.3 billion was claimed in 1964 by half of the 649,000 corporations reporting income tax, the Internal Revenue Service revealed yesterday."); *see also* Allaire Urban Karzon & Charles H. Coffin, *Extension of the At-Risk Concept to the Investment Credit: A Shotgun Approach to the Tax Shelter Problem*, 1982 DUKE L.J. 847, 852–53 (describing at-risk restrictions placed on taxpayers attempting to use the investment as a tax shelter device).

[228] *Hearing on Revenue Act of 1962*, *supra* note 28, at 2360; *id.* at 3018 (statement of D. Nelson Adams, Chairman, Tax Committee, New York City Bar Association); *see also, e.g.*, I.R.C. § 46(b) (1964) (outlining the allowance and limitations regarding carryback and carryover of unused credits); H.R. REP. NO. 87-1447, at A17 (1962) (defining I.R.C. § 38 property and the definitions and special rules necessary to the application of investment credit as outlined in § 48).

[229] Proposed Treas. Reg. § 1.46–3(d) to (e), 28 Fed. Reg. 3033–35 (1963) (to be codified at 26 C.F.R. pt. 1); *see also Report of the Committee on State and Local Taxes*, 1962 A.B.A. SEC. TAX'N 203–06 (suggesting there was lack of uniformity in the treatment of investment credit by the various states).

[230] In return for the credit, the taxpayer reduced his basis for the property whose acquisition produced the credit. S. REP. NO. 87-1881, at 19 (1962).

[231] I.R.C. §§ 38, 46–48 (1964).

[232] *See* Glasmann, *supra* note 222, at 386 n.9 (indicating that the U.S. Chamber of Commerce, the National Association of Manufacturers, the Controllers Institute, and the Machinery and Allied Products Institute each made statements in opposition to the proposal).

[233] *See 1961 House Hearings*, *supra* note 39, at 1537 (statement of John Clark, President, International Union of Mine, Mill & Smelter Workers).

[234] *See, e.g.*, *id.* (arguing the incentive tax credit is too complex, discriminatory, and difficult to administer).

[235] *See, e.g.*, 112 CONG. REC. 24,562 (1966) (statement of Messrs. Curtis, Utt, Betts, Schneebeli, and Collier) ("The rules for determining which investments will qualify for the investment credit during the suspension period because of prior commitments are exceedingly complex, and subject to manipulation by the taxpayer.").

[236] Phillippe, *supra* note 169, at 302, 307.

respects, represented a departure from the conventional income tax system.[237]

Scholars were worried that the new credit would generate wasteful tax-planning and litigation activity.[238] The tax credit's limitations on income tax liability, numerous exclusions, and complex carryback, carryover, and recapture rules, made it prone to abuse.[239] Political figures, such as the Chairman of the tax-writing Finance Committee, Senator Byrd (D-VA), professed that the tax credit was "wrong in principle and unnecessary," and "one of the largest loopholes that has ever been written into the law."[240] Furthermore, Senator Williams (R-DE), declared that this credit was too complicated to understand without the assistance of a Harvard professor.[241]

However, the vast opposition to the investment credit by the business community, professionals, and politicians did not stem solely from the reasons stated above. Indeed, the credit was thought a complex tax subsidy. But these debates did not occur in a historical vacuum. Another major reason for the instability and eventual downfall of the investment credit is the emergence of dislike toward cyclical fiscal activism.[242] While it was not clear whether the credit indeed incentivized new purchases or simply accelerated their timing, the next subpart mirrors these difficulties while describing the frequent use of the investment credit in the 1960s–1980s to direct economic change.

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[237] *See* Knickerbocker, *supra* note 188, at 78; *see also* William H. Bradley & Philip D. Oliver, *Investment Tax Credit: The Illusory Incentive*, 2 VA. TAX REV. 267, 270 (1983) ("[W]e recognize that Congress has presented the Service with a statute inherently difficult to administer because of the many close factual determinations it requires, and thus Congress shares the blame for undercutting the incentive provided by ITC."); David R. Goode, *Restoration of the Investment Tax Credit and Accelerated Depreciation*, 21 TAX LAW. 147, 160–61 (1968) (detailing the changes in the complex computation of the credit).

[238] *See, e.g.*, *1961 House Hearings*, *supra* note 39, at 3378 (statement of Robert Anthoine, Professor of Law, Columbia University); James E. Merritt, *Planning Under the "Repealed" Investment Tax Credit*, 56 A.B.A. J. 704, 707 (1970) (providing some possible planning strategies for taxpayers); John J. Raymond, *Comments on the Revenue Act of 1962*, 41 MICH. ST. B.J. 10, 16 (1962) (stating that there will be a rise in litigation and an increase in activity among accountants); *see also* Daniel N. Shaviro, *Rethinking Anti-Tax Shelter Rules: Protecting the Earned Income Tax Base*, 71 TAXES 859, 860 (1993) ("This was a key characteristic of the classic 1960s-to-1980s tax shelters that used accelerated depreciation and, often, inflated basis, but it extends further.").

[239] The basis of property subject to the credit was reduced by the amount of the investment credit regardless of whether the credit was used immediately, via the carryback, or via the carryover. These provisions are referred to as the Long amendment, which was proposed before the Senate Finance Committee. *See* 108 CONG. REC. 17,450 (1962) (statement of Sens. Douglas and Gore) (assessing the loss of revenue from this feature of the bill at somewhere between $1.1 billion to $1.4 billion); *id.* at 17,747 (statement of Sen. Kerr) (describing the change in legislation).

[240] *Id.* at 17,740, 17,742 (statements of Sen. Byrd).

[241] *Id.* at 17,744 (statement of Sen. Williams).

[242] *See supra* Part II.A (discussing how the Department of Commerce took measures to reform depreciation policy and provide incentives to invest, as well as Congress's decision to implement small business tax preferences).

C. *Cyclical Fiscal Activism: An Era of Trial and Error*

1. *The First Years*

Indeed, as Figure 3 in the Appendix demonstrates, in the years that followed the enactment of the investment credit, the nation witnessed an increase in capital formation rates, a rise in Gross National Product (GNP), and a decrease in the unemployment rate.[243] Business investment expenditures rose to record levels.[244] Although it was not clear whether these changes resulted from the adoption of the tax credit or other political and economic conditions, New Economists celebrated this upward trend as proof of the validity of their new fiscal instrument.[245]

The investment credit was depicted as a powerful cyclical device, and a prevailing method to spur changes in the market by stimulating investments in machinery and equipment.[246] However, while the Kennedy administration had intended the investment credit to be permanent,[247] the Johnson administration believed it to be a temporary, transitional measure that had been created to resolve economic deficiencies in previous years.[248] The Johnson administration was reluctant to extend the investment credit because of its cyclical association and the ambivalence toward fiscal activism.[249]

Once the justification for providing investment incentives no longer existed, with businesses overspending on capital investments, the Johnson

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[243] The average real GNP growth rate between 1961–1970 was 4.21% compared to 3.55% between 1951–1960. Paul Davidson, *Global Employment and Open Economy Macroeconomics*, *in* FOUNDATIONS OF INTERNATIONAL ECONOMICS: POST-KEYNESIAN PERSPECTIVES 9, 22, 35 (J. Deprez & J.T. Harvey eds., 1999).

[244] *See, e.g.*, M.J. Rossant, *Capital Expenditures: A Study of Administration's Efforts to Stimulate More Industry Spending*, N.Y. TIMES, Oct. 22, 1962, at 56 ("It is the first concert sign that businessmen are going to take advantage of the depreciation revision and the investment tax credit now available."); *New Orders for Machine Tools Advanced Sharply for October*, N.Y. TIMES, Nov. 23, 1962, at 58 ("Net new orders for machine tools—the machines that make machinery—advanced sharply in October.").

[245] *See Tax Changes for Shortrun Stabilization*, *supra* note 127, at 211–12 (statement of Nathaniel Goldfinger, Director, Department of Research, AFL-CIO) (noting the increase in business outlays for new plants and equipment in the early 1960s and how corporate investments in those technologies at the 1960s rate is no longer necessary).

[246] Surrey, *supra* note 17, at 478.

[247] Cook, *supra* note 170, at 227 (stating that both the accelerated depreciation and the investment credit were instituted as permanent parts of the tax code); *see also Hearing on Revenue Act of 1962*, *supra* note 28, at 2905–12 (statement of Walter A. Slowinski, U.S. Chamber of Commerce) ("Well, it is intended to be permanent, I am confident of that.").

[248] ECONOMIC REPORT OF THE PRESIDENT, *supra* note 125, at 75 ("Policy to reverse recession or speed recovery often calls for a temporary boost in private purchasing power.").

[249] *See Easy-Money Policy Is Believed in Doubt*, N.Y. TIMES, Sept. 12, 1966, at 30 (noting that President Johnson asked Congress to suspend the investment tax credit); Alan L. Otten, *Johnson's Dilemma: Hard Choices on Budget for the Great Society, Vietnam Face President*, WALL ST. J., Dec. 21, 1965, at 1 (stating that President Johnson's advisors believed skillful budgeting could avoid an immediate tax increase).

administration sought to minimize their scope.[250] Increased involvement in the Vietnam War intensified this picture.[251] Sharper defense costs further accelerated the rate of economic activity.[252] The tax credit was thought to add unsuitable emphasis to that boom in capital outlays, which created inflationary demand pressures.[253] The record pace of investment in plants and equipment was creating excessive investment demands and considerable inflationary pressures.[254] Efforts to curb these pressures necessitated restraining this capital-spending boom.[255]

2. *1966–1969: Suspension, Restoration, and Repeal*

In light of the apparent over-performance of the economy, New Economists quickly assumed an instrumental approach, utilizing tax policy as a temporary stabilizing device.[256] To achieve this goal, they suspended the investment credit in 1966.[257] Proponents of the suspension of the investment credit explained that a temporary holdup would be useful in

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[250] The Johnson administration used the freed revenues in a series of "Great Society" legislations that upheld civil rights, Medicare, Medicaid, and environmental protection, among others. *See, e.g.*, Edwin L. Dale, Jr., *Spending to Rise for Great Society: $3.3-Billion More Provided in '67 Budget—Cost of War Is Put at $10.5 Billion*, N.Y. TIMES, Jan. 16, 1966, at 1 (discussing how Great Society programs addressing health, education, poverty and pollution have experienced a growth of $3.3 billion); Thomas J. Foley, *Great Society in Search of Great Ideas*, L.A. TIMES, Aug. 1, 1965, at L1 (stating that the Great Society must address new challenges to fully pursue and achieve its goals); *Johnson Signs 8 Bills Supporting Great Society: Hails 'Great' 89th Congress, 'Great Day' Back Home and G.O.P. Support*, N.Y. TIMES, Nov. 4, 1966, at 20 (discussing bills addressing education, urban renewal, healthcare, consumer protection, medical training, and pollution).

[251] *See* Shaviro, *supra* note 14, at 109 (referencing the United States' decision to simultaneously take part in the Vietnam War and institute expensive domestic programs without tax increases as an example of the conflict over the merits of tax reform and its political appeal).

[252] *See* Surrey, *supra* note 17, at 478–79 (explaining how the costs of the Vietnam War created a sharp rise in the defense budget and amplified the rate of economic activity).

[253] *Id.* at 478 ("A sharply rising defense budget superimposed on the rapidly expanding private economy suddenly accelerated the rate of economic activity."); *see also Hearings on the President's 1967 Tax Proposals*, *supra* note 22, at 519 (statement of Joseph A. Pechman, Director of Economic Studies, Brookings Institution) (arguing that suspending the investment credit in 1966 would have resulted in lower prices); *Table of Historical Inflation Rates*, *supra* note 51 (illustrating increased inflation rates between 1965 and 1969).

[254] *See Tax Changes for Shortrun Stabilization*, *supra* note 127, at 213–16 (statement of Nathaniel Goldfinger, Director, Department of Research, AFL-CIO) (discussing how increased spending by businesses on equipment and plants is unsustainable and is generating inflationary pressures in the private economy).

[255] See George E. Zeitlin et al., *Federal Income Taxation*, 1967 ANN. SURV. AM. L. 717, 719 nn.11–12 for a discussion of the New Economics in the congressional reports.

[256] *See* Kenyon E. Poole, *Some Aspects of the Role of Government in Stable Growth*, 20 U. FLA. L. REV. 464, 481–82 (1968) (stating that the role of government in maintaining and balancing stable market growth was also observed in foreign countries' experience of achieving success in establishing a series of plans to correct instability and a rise in standards of economic performance).

[257] *See Suspensions of Investment Credit and Accelerated Depreciation: Hearings on H.R. 17607 Before the Comm. on Fin.*, 89th Cong. 36–45 (1966) [hereinafter *Suspension of Investment Credit Hearings*] (statements of Treasury Secretary Fowler).

encouraging businesses to delay capital investments, until a later time that might be more suited to the economic conditions of the market.[258] Those who supported the retention of the investment credit warned against introducing more uncertainty into the market, either by creating a stampede to quickly deliver equipment before the effective date of the suspension, or by postponing expansion plans until the suspension period ended.[259]

Only a few years after its enactment, the investment credit's biggest adversary, the Chamber of Commerce, began to advocate for making the tax credit a permanent part of the tax structure.[260] Once constituents realized the significant monetary benefits of the new credit, concerns for certainty and neutrality were pushed aside.[261] These different viewpoints demonstrated the insufficient knowledge and inadequate analysis of the effects of the investment credit as a countercyclical tool and an economic stabilizer.[262] The few surveys that were conducted were limited and displayed little prospective impact on the business decisions of modernizing facilities and incentivizing capital investments.[263] Other studies on the future effect of temporary suspension of the investment credit on capital investments continued to cast considerable doubts on the effectiveness of the tax credit in spurring capital investments.[264]

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[258] *E.g.*, 112 CONG. REC. 22,049 (1966) (prepared statement of Pres. Johnson) ("I recommend that the Congress promptly make inoperative, for a temporary period, those special incentives for plant and equipment investment and commercial construction that currently contribute to overheating the economy."); *id.* at 22,064 (statement of Rep. Wyatt); *see also Suspension of Investment Credit Hearings*, *supra* note 257, at 5 (statement of Treasury Secretary Fowler) ("The temporary removal of these special tax incentives to investment will . . . contribute to a restraint of inflationary developments that are proving disruptive of the financial markets and placing excessive strain on the capital goods industries . . . .").

[259] *See, e.g.*, 112 CONG. REC. 22,393 (1966) (statement of Sen. Williams) ("A repeal of the investment tax credit alone and no other action would achieve nothing."); *id.* at 23,862 (statement of Sen. Javits) ("To suspend credit for 16 months will induce businessmen to deter marginal projects until the credit is restored."); *id.* at 17,536 (statement of Rep. Ullman) ("In order to avoid disastrous rush of plant and equipment orders, the suspension is effective immediately . . . ."); *Suspension of Investment Credit Hearings*, *supra* note 257, at 165 ("If the threat of enactment is taken seriously by industry, such a proposal is bound to touch off a stampede for the acceleration of equipment deliveries scheduled after the deadline (its enactment would of course have the same effect). Again the result will be the opposite of that intended. There considerations raise grave doubts about the effectiveness of credit suspension as a means of restraint, quite apart from the administrative difficulties to which it gives rise." (emphasis omitted)).

[260] *Tax Changes for Shortrun Stabilization*, *supra* note 127, at 64 (statement of Nathaniel Goldfinger, Director, Department of Research, AFL-CIO).

[261] Cook, *supra* note 170, at 231.

[262] *Id.* at 233.

[263] *See* Supplemental and Minority Views of Sens. Paul Douglas & Albert Gore, *supra* note 178, at 1100 (describing surveys on the meager effect of the investment credit on capital equipment investments decisions).

[264] NAT'L INDUS. CONFERENCE BD., INVESTMENT STATISTICS: SPECIAL SURVEY: THE SUSPENSION OF TAX INCENTIVES—IMPACT ON CAPITAL INVESTMENT (1966) (surveying 1,000 of the

Ultimately, Congress temporarily suspended the investment credit for a short period.[265] The role of the Tax Adjustment Act of 1966 was to employ fiscal restraint for anti-inflationary purposes.[266] For the first time in history, tax policy was openly utilized as a short-range economic stabilizer as opposed to its revenue-raising role in previous decades. In a press conference, President Johnson explained, "We won't give you a bonus to do what we don't want you to do."[267]

Yet, even while suspending the credit, the government was already contemplating the early termination of the suspension.[268] Since the key reason for suspending the tax credit was to slow down all equipment purchase activity, the suspension period covered not only property actually built or acquired, but also property ordered during the moratorium period.[269]

The market reaction to the suspension was noticeable. Capital investment began to taper off.[270] Massive cancellation of orders of equipment and machinery was followed by a period of credit holdup.[271] The growth rate of investment in plants and equipment dropped to 4% in 1967, down from 14%–17% in previous years.[272] The suspension impacted

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largest manufacturers on future effects of the temporary suspension of the tax credit and finding an anticipated 1.3%–2.8% reduction).

[265] Congress suspended the Investment Credit from October 10, 1966 through December 31, 1967. STAFF OF J. COMM. ON INTERNAL REVENUE TAXATION, 89TH CONG., SUMMARY OF THE ACT TEMPORARILY SUSPENDING THE INVESTMENT CREDIT AND LIMITING THE USE OF ACCELERATED DEPRECIATION 1467 (Comm. Print 1966).

[266] Surrey, *supra* note 17, at 479.

[267] Press Conference of President Lyndon Johnson, Statement on the Message on Fiscal Policy (Sept. 8, 1966), http://www.presidency.ucsb.edu/ws/index.php?pid=27843 [https://perma.cc/9HE6-GGA9]. In his 1966 Economic Report, President Johnson added, "improvement of our tax system is a continuing need which will concern this Administration and which deserves the support of all Americans." 112 CONG. REC. 1268 (1966). Contributing to suspension of the investment credit was the objection of some congressional representatives to submit to a theory that required them to change the laws and direct the market so frequently. *See, e.g.*, *Hearings on the President's 1967 Tax Proposals*, *supra* note 22, at 103 (statement of Rep. Gilbert); Representative John W. Byrnes, Address Before the International Fiscal Association (Apr. 20, 1967), *reprinted in* 1967 Stand. Fed. Tax Rep. (CCH) § 6178; Representative Wilbur D. Mills, Address at the American Enterprise Institute Symposium (Apr. 20, 1967), *reprinted in* 1967 Stand. Fed. Tax Rep. (CCH) § 6178.

[268] *Suspension of Investment Credit Hearings*, *supra* note 257, at 382 (statements of Donald B. Thrush, Chairman, Government Affairs Committee, Printing Industries of America, Inc., and Edmund F. Martin, Chairman and CEO, Bethlehem Steel Corp.).

[269] That would have been unlikely had companies been able to continue to place orders for manufacture and merely defer the delivery dates. *See id.* at 383 (statement of Edmund F. Martin, Chairman and CEO, Bethlehem Steel Corp.).

[270] *Hearing on the President's 1967 Tax Proposals*, *supra* note 22, at 119 (statement of Treasury Secretary Fowler).

[271] *See Hearings on H.R. 6950 Before the H. Comm. on Ways & Means*, 90th Cong. 6–7 (1967) (statement of Treasury Secretary Fowler).

[272] *Infra* Appendix fig.3; *see also* 113 CONG. REC. 5946 (1967) (statement of Sen. Proxmire).

several industries, which saw a fall in the number of tool and machinery orders of over 80% since going into effect.[273]

Consequently, the Johnson administration pushed for tax increases,[274] relying on the CEA and leading economists, such as Joseph Pechman, who supported fiscal management.[275] Soon after, in March 1967, the administration was back in Congress with a restoration bill.[276] The suspension lasted only five months; it was brought back on May 31, 1967, and was applied retroactively to March 9, 1967.[277] George Terborgh, research director of the Machinery and Allied Products Institute, summarized this period stating, "While the adoption of the bill mercilessly ended a fiasco, it did not terminate the headaches of the episodes."[278]

While an economic effect during the cyclical use of the investment credit was notable, it was not clear that the instrument indeed spurred new capital investment that would not have happened otherwise rather than advancing the occurrence of already anticipated purchases. Studies on the projected effect of the credit on spurring capital investments showed only a modest expected reduction, if any, among the largest manufacturing companies at that time.[279] Professionals began to question the effectiveness of utilizing the investment credit as an intermittent apparatus.[280]

Northwestern University economist Kanyon Poole emphasized at that time that it is not clear special investment tax incentives are truly needed.[281] He argued that investments and savings are not necessarily

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[273] 113 CONG. REC. 6004 (1967) (statement of Sen. Carlson) (reporting that industries such as railroad equipment manufacturers experienced a drop in orders of eighty percent).

[274] *E.g.*, *Hearings on the President's 1967 Tax Proposals*, *supra* note 22, at 1–7 (prepared statement of Pres. Johnson).

[275] *Id.* at 518–25 (statement of Joseph A. Pechman, Director of Economic Studies, Brookings Institution).

[276] Restoration of Investment Credit and Accelerated Depreciation Provisions, 1 PUB. PAPERS 303 (Mar. 9, 1967). Although the bill was swiftly passed in the House, the Senate Finance Committee disagreed with the changes made in the House version, which retroactively expanded the types of cases in which the tax incentives were to be made available. The committee reported that the House version of the bill was discriminatory against taxpayers who postponed investments compared to taxpayers who ordered equipment or began construction during the suspension period. S. REP. NO. 90-79, at 2 (1967).

[277] H.R. 6950, 90th Cong. (1967); Gerald J. Holtz & Harold R. Jenkins, *Restoration of Investment Credit and Accelerated Depreciation*, 45 TAXES 660, 660 (1967) (reporting that the suspension period was shortened to March 9, 1967, instead of December 31, 1967, and eventually took place from October 10, 1966 to March 9, 1967, with the limitation on the amount of investment credit that could be claimed in any one year increased from 25% to 50% as of March 9, 1967).

[278] Kraus, *supra* note 1, at 61 (citing TERBORGH, *supra* note 114, at 155)). Others argued that the effect of the tax credit was noticeable, to some degree, in marginal industries and on small businesses. Cook, *supra* note 170, at 233.

[279] *Supra* note 264.

[280] Supplemental and Minority Views of Sens. Paul Douglas & Albert Gore, *supra* note 178, at 1100; Cook, *supra* note 170, at 231.

[281] Poole, *supra* note 256, at 465.

created independently and as an outcome of tax inducements.[282] Congressional representatives refused to fully submit to a theory that required them to change the laws and direct the market so frequently.[283] In his role as Assistant Secretary of the Treasury for Tax Policy at that time, Stanley S. Surrey promoted the enactment of the new tax credit.[284] However, after stepping down from his position, Surrey criticized the use of the credit as a countercyclical device.[285] Although the investment credit was kept under the radar in other countries,[286] the legislative process in the United States made it impossible to avoid signaling to the market when the tax benefit was scheduled to be suspended or restored. This was said to inherently harm the nature and effectiveness of the tax measure.[287] Support of fiscal activism and cyclical fine-tuning began to dwindle.

The growing U.S. participation in the Vietnam conflict, with peak involvement in 1968, continued to create a build-up in capital spending and deployment of war-related industries.[288] In 1969, investments in new plants and equipment were at a high point.[289] The investment credit was sought to augment these inflationary pressures by stimulating demand even further.[290] As a result, the Treasury sought to place a higher national priority on the need for general taxpayer relief. In his tax reform message on April 21, 1969, President Nixon repealed the investment credit, viewing it only as an emergency instrument and transitional measure to correct

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[282] *Id.* at 475.

[283] *See, e.g.*, Byrnes, *supra* note 267; Mills, *supra* note 267.

[284] *Tax Changes for Shortrun Stabilization*, *supra* note 127, at 243 (statement of Stanley S. Surrey, Assistant Secretary of the Treasury) ("These effects would cover a wider range of investment—including inventories and accounts receivable—than would a change in the investment credit."); *see also* Diane Ring, *International Tax Relations: Theory and Implications*, 60 TAX L. REV. 83, 144 (2007) (describing the central role of Stanley Surrey in the foreign policy arena).

[285] Later on, Surrey argued against utilizing the credit as a countercyclical device since the effect of the investment credit is also directly influenced by corporate tax changes and indirectly by individual income tax rates. Surrey, *supra* note 17, at 481.

[286] *Tax Changes for Shortrun Stabilization*, *supra* note 127, at 60 (statement of Robert A. Gordon, Professor of Economics, University of California, Berkeley) ("In a *different* form, the Swedish government has been using tax incentives to investment for a number of years as an integral part of its stabilizing fiscal policy." (emphasis added)).

[287] *Id.* at 299 (statement of Norman B. Ture, National Bureau of Economic Research) ("If compensatory action is substantially delayed, whether because of the recognition lag or because of tardy agreement about the kind and amount of action to take, efforts to stabilize conceivably could contribute to instability, particularly if the speed with which compensatory measures take effect is overestimated.").

[288] Heller, *supra* note 162, at 17.

[289] *See infra* Appendix fig.3 (portraying business expenditures for new plan and equipment from 1948 to 1971).

[290] STAFF OF J. COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., SUMMARY OF PROBLEMS PRESENTED IN STATEMENTS SUBMITTED TO COMMITTEE ON WAYS AND MEANS WITH RESPECT TO TREASURY PROPOSAL TO REPEAL THE INVESTMENT CREDIT 1–6 (Comm. Print 1969).

deficiencies in the tax structure on a temporary basis.[291] The investment credit was thought to have "fulfilled its purpose of increasing investments during a period of slack demands and has outlived its usefulness as a stimulant to the economy."[292] The shift in tax policy and discourse on the role of the tax system was underway. From now on, public debate turned to the question, "should taxes be used to implement economic policy?" Answering this query, James E. Merritt wrote:

> [we] must consider this much larger question: have the opponents of the use of tax laws as an economic incentive convinced the administration and Congress to refrain from the use of these tax incentives as a matter of principle, or are tax incentives an irresistible method for attempting to achieve desired social and economic results?[293]

The next subpart reveals that this repeal, too, did not last long. The experimentation in fiscal activism was still in motion.

3. *1971–1975: Reinstatement and Increase*

During 1970, inflationary pressures grew stronger than at any time since the Korean War, and were not restricted to domestic monetary and fiscal policies;[294] there had been a dire competition with foreign manufacturers and an ongoing balance-of-payments problem.[295] Calls to restore the investment credit were accompanied by pleas for fiscal restraint and a compulsory savings plan.[296] The Federal Reserve warned that "violent price increases that stem from such sources cannot readily be handled with customary weapons of economic stabilization policy."[297]

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[291] ECONOMIC REPORT OF THE PRESIDENT 75 (1969), http://www.presidency.ucsb.edu/economic_reports/1969.pdf [https://perma.cc/6R4K-7CZS] ("The net stimulus from these actions [enactment of an investment tax credit] worked in the right direction, but was inadequate to the major task of reaching potential output.").

[292] Congressman Jerry Ford, *Your Washington Review*, FORD LIBR. MUSEUM (July 2, 1969), http://www.fordlibrarymuseum.gov/library/document/0054/4525476.pdf [https://perma.cc/3VYE-PBXK] (describing President Nixon and the Ways and Means Committee sentiment about the repeal of the investment credit).

[293] Merritt, *supra* note 238, at 707.

[294] Heller, *supra* note 162, at 19.

[295] *See* H.R. REP. NO. 92-533 (1971), *reprinted in* 1971 U.S.C.C.A.N. 1825; S. REP. NO. 92-437 (1971), *reprinted in* 1971 U.S.C.C.A.N. 1918, 1931 ("[The credit] should be restored as a means of providing stimulus to the lagging domestic economy by reducing the cost of capital to U.S. manufacturers . . . to place them in a more competitive position with foreign manufacturers and in that manner [would] help improve our present serious balance-of-payments situation.").

[296] *Statement by Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System Before the Joint Economic Committee, August 3, 1973*, 59 FED. RES. BULL. 567, 570, 572 (1973) [hereinafter *Statement by Arthur F. Burns*] ("Additional fiscal restraint is also needed at this time. . . . [I]nvestment tax credit or a compulsory savings plan—that could be quickly reversed . . . .").

[297] *Id.* at 569.

Notwithstanding his declarations to dogmatically reject the idea of cyclical fiscal activism, President Nixon began to recognize New Economics theory's political appeal and its political use in attaining certain economic objectives.[298] Following the CEA recommendation, he announced a series of fiscal policy actions in line with New Economics.[299]

As a first step, President Nixon put in place a price control program on certain foods, wages, and domestic goods in order to moderate inflationary pressures.[300] Second, he instructed the Federal Reserve to restrain monetary policy and limit Federal expenditures.[301] Finally, he reinstituted the investment credit,[302] and while the Nixon administration recommended reinstating a 10% credit,[303] Congress restored the credit at its historical 7% level for budgetary reasons.[304] Scholars commented that a bloc of pro-business votes made that legislative process, including the restoration of the investment credit, politically effortless.[305]

Economic recovery began to occur in early 1971 and gained considerable momentum during 1972.[306] Employment and income levels increased strongly; sales and new orders gradually improved, creating an environment of moderate price increases.[307] The rate of expansion in aggregate economic activity rose further in the closing months of 1972, and rapid expansion continued into 1973.[308] The Federal Reserve acknowledged a number of factors that assisted this economic recovery and gain in business capital spending, amongst them the restoration of the

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[298] On August 15, 1971, President Nixon ended the international convertibility of the dollar to gold, which resulted in the so-called "Nixon Shock." There was no correspondent plan put in place to revalue currencies until more than a year later. Credit demands were unusually heavy, and interest rates were at extremely high levels, at over eight percent. *See* ELLIOT W. BROWNLEE, FUNDING THE MODERN AMERICAN STATE: 1941–1945, at 209 (2013).

[299] *Id.* at 215; *Statement by Arthur F. Burns*, *supra* note 296, at 569–72.

[300] *See* Heller, *supra* note 162, at 17–18 (discussing the combination of wage-price controls and tax cuts in 1971, which were intended to "subdue inflation and energize expansion").

[301] *See id.* at 18 (noting the "about-face" from "ease to tightness" of the Federal Reserve).

[302] Revenue Act of 1971, Pub. L. No. 92-178, § 101, 85 Stat. 497, 498–99.

[303] *See Tax Proposals Contained in the President's New Economic Policy: Hearings on the Tax Proposals Contained in the President's New Economic Policy Before the H. Comm. on Ways & Means*, 92d Cong. 7–8, 11 (1971) [hereinafter *Hearings on the Tax Proposals Contained in the President's New Economic Policy*] (statement of Treasury Secretary John B. Connally); Gerard M. Brannon, *The Revenue Act of 1971—Do Tax Incentives Have New Life?*, 14 B.C. INDUS. & COM. L. REV. 891, 897 (1973). After August 15, 1972, the credit would have been reduced to five percent. *Hearings on the Tax Proposals Contained in the President's New Economic Policy*, *supra*, at 11 (statement of Treasury Secretary John B. Connally).

[304] Revenue Act of 1971 § 101; Brannon, *supra* note 303, at 897.

[305] *E.g.*, Brannon, *supra* note 303, at 897.

[306] *1972: A Year of Accelerating Recovery*, 59 FED. RES. BULL. 1, 1 (1973).

[307] *Id.*

[308] *See id.* at 4 (describing how the business capital investment contributed to the overall strength of the economy).

investment credit in late 1971.[309] Arthur F. Burns, Chairman of the Federal Reserve Board, proposed a permanent interchangeable version of the investment credit, in accordance with cyclical fiscal activism principles,[310] but his proposal was stymied by the Nixon administration, which refused to fully commit to the New Economics philosophy.[311]

From January 1973 until December 1974, the world experienced one of its major stock markets downturns in modern history.[312] This market recession was exacerbated in November 1973, when a spike in oil prices occurred as a result of an oil embargo issued by the Organization of Arab Petroleum Exporting Countries against the United States for its involvement in the Middle East conflict.[313] The sharp increase in oil prices, coupled with high government spending due to the Vietnam War, led the nation to a stagnation period of three years.[314] The U.S. economy's GDP growth rate dropped to 2.1%, and inflation rates soared from 3.4% in 1972 to 12.3% in 1974.[315] In order to curb inflation and augment the effect of the investment credit on spurring capital investments, President Ford followed the advice of New Economists at the CEA and recommended that the investment credit be increased and made refundable.[316] Though the latter

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[309] *Id.*; *see also Federal Fiscal Policy, 1965–72*, 59 FED. RES. BULL. 383, 395 (1973) ("[T]he reinstitution of the investment credit in December 1971 was a contributing factor to the fast economic growth that was experienced in 1972.").

[310] *See The 1973 Economic Report of the President: Hearings Before the J. Econ. Comm.*, 93d Cong. 396–97, 401 (1973) (statement of Arthur Burns, Chairman, Federal Reserve) (noting the expansion of economic activity during 1972, that such expansion was likely to continue, and urging Congress to consider a permanent variable investment tax credit to facilitate a more effective stabilization policy); *see also* Arthur Burns, Address at the International Monetary Conference: Some Problems of Control Banking 4 (June 6, 1973) (arguing that the "rather large fluctuation characteristic" of business investment was a "major force" behind economic instability, and recommending that the tax investment credit remain in effect continuously).

[311] Robert Eisner, *Business Investment Preferences*, 42 GEO. WASH. L. REV. 486, 490 (1974).

[312] *See* E. Philip Davis, *Comparing Bear Markets—1973 and 2000*, 183 NAT'L INST. ECON. REV. 78, 78–79 (2003) (comparing market weakness in the G-7); *see also* Bryan Burrough, *Back in Action: Companies Take Over the Takeover Game from Flashy Raiders*, WALL ST. J., Jan. 25, 1988, at 1 (describing how low prices resulting from the market crash were followed by hostile corporate takeovers).

[313] *See generally* VITO A. STAGLIANO, A POLICY OF DISCONTENT: THE MAKING OF A NATIONAL ENERGY STRATEGY 23 (2001) (discussing how, after OAPEC announced the 1973 oil embargo, reduced its production levels, and closed the Suez Canal, oil supplies to the international market severely decreased, world oil prices quadrupled, and President Nixon feared what he called "the most acute shortages of energy since World War II"); James W. McKie, *The United States*, *in* THE OIL CRISIS 73, 73 (Raymond Vernon ed., 1976) (discussing the political and economic impacts of the oil embargo); Gene Smith, *Northeast Is Bracing Itself for a Possible Energy Crisis*, N.Y. TIMES, Jan. 15, 1973, at 1 (describing the scope and impact of the oil crisis).

[314] Figure 4 in the Appendix illustrates this short period of stagnation, as reflected in new capital equipment investments. *See also* TODD A. KNOOP, RECESSIONS AND DEPRESSIONS: UNDERSTANDING BUSINESS CYCLES 165 (2004).

[315] Davis, *supra* note 312, at 81 tbl.4.

[316] H.R. DOC. NO. 93-366, at 4 (1974); Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C. INDUS. & COM. L. REV. 679, 714

goal was not attained, in the Tax Reduction Act of 1975[317] the Ford administration succeeded in passing a major tax cut coupled with an increase of the investment credit from 7% to 10%.[318]

4. *Final Years*

By mid-1975, the economy had recovered and returned to its normal capacity.[319] Businessmen and professionals continued to call for permanent extension of the investment credit.[320] Its cyclical nature—that is, its on-again-off-again character—made it an unreliable factor in facility planning.[321] Congress responded by enacting the Tax Reduction and Simplification Act of 1977[322] that kept the investment credit temporarily at its ten percent level.[323] In 1979, an increase in Iranian oil prices created a worldwide energy crisis.[324] Spiking oil prices led the government to tighten its monetary policy to control inflation, and a short recession followed

(1976). For arguments in support of making the tax credit fully refundable, see generally Paul R. McDaniel, *Tax Reform and the Revenue Act of 1971: Lesions, Lagniappes and Lessons*, 14 B.C. INDUS. & COM. L. REV. 813, 838–39 (1973) (proposing a refundable tax credit that would eliminate tax expenditures for taxpayers, yet continue to provide federal financial benefits through the tax system); Emil M. Sunley, Jr., *Towards a More Neutral Investment Credit*, 26 NAT'L TAX J. 209, 216 (1973) (arguing that the investment credit could be made more "neutral" if it were, inter alia, fully refundable).

[317] *See* H.R. REP. NO. 94–19, at 25 (1975) (listing the Tax Reduction Act of 1975's investment credit as one of the "nonrefundable" credits).

[318] Tax Reduction Act of 1975, Pub. L. No. 94-12, §§ 201–301, 89 Stat. 26, 28–36 (codified in scattered sections of 26 U.S.C.). By 1975, the prices of industrial raw materials had begun to decline and employment and production had decreased rapidly. *Statements to Congress: Statement by Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System, Before the Committee on Ways and Means, U.S. House of Representatives, January 30, 1975*, 61 FED. RES. BULL. 60, 69 (1975). Unemployment had risen sharply to over seven percent of the labor force. *Id.* at 60. Accordingly, the administration sought to increase the extent of the investment credit to temporarily boost capital demand and to encourage greater monetary and credit expansion. *Id.* at 62. In a statement before the Committee on Ways and Means, Arthur Burns said: "[W]hile the Federal Reserve recognizes all this, we are also mindful of the lesson of history that rapid growth of the money supply will lay the base for a new wave of inflation." *Id.* at 63.

[319] *See* Robert M. Coen & Bert G. Hickman, *Investment and Growth in an Econometric Model of the United States*, 70 AM. ECON. REV. 214, 219 (1980).

[320] For a law partner's argument in support of the permanent extension of the investment credit, see John C. Argue, *The Investment Credit After the Tax Reduction Act of 1975*, 51 L.A. B.J. 194, 194 (1975) (describing the investment credit as very significant for the business-professional community). *See also* Francis P. Carolan & Timothy C. Sentner, *Added Potential in the Investment Credit*, 28 TAX EXECUTIVE 222, 222 (1976) (arguing that the investment credit is the most important measure that the federal government took to assist businesses in obtaining capital).

[321] *See, e.g.*, W. Bruce Thomas, *How to Increase Capital Formation*, 29 TAX EXECUTIVE 1, 12 (1977) (calling for an increase in measures to create capital, including increasing the investment credit to twelve percent and making it permanent).

[322] S. REP. NO. 95-66, at 1 (1977).

[323] *Id.* at 63. The Revenue Act of 1978 permanently extended the maximum ten percent credit. Revenue Act of 1978, Pub. L. No. 95-600, §§ 311–17, 92 Stat. 2763, 2824–30 (codified as amended at I.R.C. §§ 46–50 (2012)).

[324] James D. Hamilton, *Historical Causes of Postwar Oil Shocks and Recessions*, 6 ENERGY J. 97, 111 (1985).

during 1981–1982.[325] Accordingly, the Senate Finance Committee recommended increasing the investment credit to stimulate capital formation and improve the nation's competitiveness in international trade.[326] Still, dislike toward cyclical fiscal activism kept the investment credit at its previous levels for several years.[327] Aggressive tax planning and vast tax shelter activity exacerbated the public hostility toward tax preferences generally and the investment credit specifically.[328] In the major 1986 tax reform, this skepticism prevailed. Tax scholars Ajay Mehrotra and Joseph Thorndike described the nature of tax policy during that period:

> The changing political and economic conditions of the 1960s and 1970s brought new unease to the nation's fiscal debates. Spiraling inflation—induced by increased government spending on the Vietnam conflict and Great Society programs—together with an oil crisis and the demise of the Bretton Woods system of fixed exchange rates all signaled an end to post-WWII American economic prosperity and hegemony. The resulting loss of faith in government to manage the economy led to the emergence of an anti-statist, neoliberal ideology that found expression in tax policy. . . . In Washington, piecemeal erosion of the tax base—a phenomenon at least as old as the income tax—left many experts worried about the future of the revenue system. As exemptions, deductions, credits, and other tax benefits littered the Internal Revenue Code, tax specialists pondered the prospects of broadening the income tax base by removing many of these tax benefits. Meanwhile, a wave of tax revolts in states around the nation produced a surge of new tax and spending limits, recasting the landscape of subnational politics.[329]

As a result of that atmosphere, the most sweeping tax legislation in the history of the Internal Revenue Code to this day was manifested in the Tax Reform Act of 1986.[330] This act reflected a major shift in tax policy, which

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[325] *Id.* at 111–12 (describing the correlation between the energy crisis and the recession in the United States).

[326] The Senate Finance Committee declared that "present rules for determining depreciation allowances and the investment credit need to be replaced because they do not provide the investment stimulus that is essential for economic expansion." S. REP. NO. 144, at 47 (1981).

[327] *See infra* Appendix fig.2.

[328] Daniel N. Shaviro, *Risk and Accrual: The Tax Treatment of Nonrecourse Debt*, 44 TAX L. REV. 401, 424–26 (1989) (describing the tax shelter activity from the late 1960s through 1986).

[329] Mehrotra & Thorndike, *supra* note 13, at 618–19.

[330] Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085; Rodger A. Bolling et al., *The Tax Reform Act of 1986: Simplification or Complication?*, 39 TAX EXECUTIVE 235, 239 (1987) ("The 1986 Act is the most sweeping tax legislation in the 73-year history of the Internal Revenue Code.").

at that time focused on simplicity, fairness, equity, and economic neutrality.[331] Support for a "fairer" tax code and tax neutrality received growing bipartisan support set to scrutinize complex and costly tax sections and avoid fiscal activism.[332] The 1986 tax reform focused on lowering rates and expanding the base by eliminating many tax preferences.[333] To compensate for the losses in revenue caused by individual income tax reduction and corporate rate reduction, the 1986 Act repealed a host of exclusions, deductions, and credits primarily used by corporate taxpayers.[334] Prior to the enactment of the 1986 Act, the revenue loss estimates from the investment credit for 1986 were projected at $30.9 billion,[335] which together with its dubious and complex nature made it an obvious target for repeal. The ideological aversion to cyclical fiscal activism and skepticism regarding its effect on the economy reinforced the notion that the investment credit should be put to rest.[336]

The immediate expensing rule was left intact for its small business affiliation and relative simplicity. Prior to President Reagan signing the 1986 Act into law, lobbyists and other interest groups acted vigorously to reinstate the investment credit without much success.[337] Yet, in proposing

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[331] *See* GEN. ACCOUNTING OFFICE, INVESTMENT TAX CREDIT: UNRESOLVED ISSUES 24 (1978) (noting that corporate tax incentives interfere with the free flow of market forces); *see also* Eisner, *supra* note 311, at 486 (describing how tax incentives for businesses distort the economy); Charles R. Hulten & James W. Robertson, *The Taxation of High Technology Industries*, 37 NAT'L TAX J. 327, 327 (1984) (concluding that the market should allocate resources instead of the government trying to pick winners); Jonathan R. Kesselman et al., *Tax Credits for Employment Rather than Investment*, 67 AM. ECON. REV. 339, 348 (1977) (concluding that an employment tax credit would have benefited the labor market far more than an investment tax credit).

[332] Bolling et al., *supra* note 330, at 237 (citing Treasury Secretary James A. Baker III remarking, "This is a very significant change. We're going to have a far more efficient system than we have now").

[333] *See id.* at 239 (noting efforts by Congress to eliminate tax breaks and loopholes); Simmons, *supra* note 24, at 151.

[334] Simmons, *supra* note 24, at 151; Edward Yorio, *Equity, Efficiency, and the Tax Reform Act of 1986*, 55 FORDHAM L. REV. 395, 439 (1987). Opponents of the repeal of business incentives, such as Representative Marjorie S. Holt, opposed the effect such action would have on the economy. *See* 65 CONG. DIG. 51 (1986) (statement of Rep. Holt) ("My concern is the economic consequences of the legislation, and I have concluded that it will retard capital formation and investment, restrict economic growth, and cause higher unemployment.").

[335] *See* CONG. BUDGET OFFICE, TAX EXPENDITURES: CURRENT ISSUES AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1982–86, at 81–84 (1981). For 1990, the revenue loss was projected at $8 billion. *See* STAFF OF J. COMM. ON TAXATION, 99TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 1986–1990, at 10–21 (Comm. Print 1985).

[336] *See Hearings on the Tax Proposals Contained in the President's New Economic Policy*, *supra* note 303, at 1178–81 (statement of James S. Fralick, Assistant Professor of Economics, Fordham University) (detailing the various credibility problems, including questionable economic impact and some political dilemmas, that the investment credit has presented in history).

[337] *See* Joan C. Szabo, *Welcome to Tax Reform*, NATION'S BUS., Nov. 1986, at 20, 22 (discussing calls for change to the Tax Reform Act of 1986 before its passage); *see also* Bolling et al., *supra* note 330, at 237, 243.

to repeal the investment credit, the Ways and Means Committee reasoned that there was no conclusive evidence it accomplished its intended purpose and stimulated capital investment to a degree sufficiently significant to produce economic growth.[338] The Committee professed that the investment credit merely shifted the timing of equipment purchases that would have taken place regardless of the credit.[339] On October 22, 1986, the Tax Reform Act put an end to the controversial history of the investment credit along with the experimentation in cyclical fiscal action.[340]

V. CONCLUSION

History teaches us many important lessons. Here the message is loud and clear. Cyclical fiscal activism is a pill that is difficult to swallow. The investment credit had a more onerous calling than the typical tax credit. It represented far-reaching measures to influence the economic market in a countercyclical manner. The investment credit was part of a complex experiment in New Economics theory and market regulation. It represented the transformation of the tax system from a revenue-raising device to an economic stimulus instrument. The decreasing confidence in the efficiency of fiscal management of capital investments and its intricate nature led to the repeal of the investment credit while the immediate expensing rule was expanded and perpetuated to this day.

History also demonstrates that immediate expensing's path dependency was perpetuated due to its title, which contained the proverbial "small business" and its rather simple nature.[341] These topics continue to receive congressional attention today.[342] Regulatory compliance costs, credit problems, and the federal tax burden of small businesses will remain

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[338] Yorio, *supra* note 334, at 416; *see also* S. REP. NO. 99-313, at 33, 39 (1986); H.R. REP. NO. 99-426, at 84, 145 (1985).

[339] *See* Douglas Holtz-Eakin, *The Tax Reform Act of 1986: Simplicity, Equity, and Efficiency*, 4 AKRON TAX J. 69, 80 (1987) ("These features are the components of many popular tax shelters. While individually advantageous, they have produced serious problems in the allocation of capital stock.").

[340] 26 U.S.C. §§ 46–48 (1988). Technically, these sections were "amended" in 1986, but *de facto* were repealed.

[341] In 1978, the House admitted in a report on depreciation that immediate expensing was enacted to provide a special incentive for small businesses. *See* H. REP. NO. 95-1445, at 109 (1978) ("The committee believes that the additional first-year depreciation provision should be liberalized to provide a greater incentive for small businesses to invest in depreciable machinery and equipment."). The Senate report on the Economic Recovery Tax Act of 1981 reiterated the fact that under present law there are no special provisions specifically applicable to depreciation of assets by small business. S. REP. NO. 97-144, at 44 (1981); *see also* Eyal-Cohen, *supra* note 10, at 55 (discussing and providing an example of the path dependency of small business tax preferences).

[342] *E.g.*, American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313; Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504; Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296; American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.

on the political agenda.[343] Declarations of politicians promising benefits to the "little guy" to win the public vote will persist and reinforce this route.[344] Over the years, the House and Senate Select Small Business Committees and the Small Business Administration have managed to propose and engrave small business legal preferences, reflecting a heavy investment by our legal system.[345]

The anomaly of the immediate expensing and investment credit narratives is relevant today. Congress is currently debating several proposals put forth to reform the business tax regime. Among those proposals are suggestions to increase the immediate expensing limits and make them permanent[346] and to allow *the entire cost* of any qualified investments to be immediately deductible.[347] On the other hand, over the

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[343] *See* Mirit Eyal-Cohen, *Legal Mirrors of Entrepreneurship*, 55 B.C. L. REV. 719, 771–72 (2014) (discussing the value of acknowledging the importance of livelihood businesses in political discourse); Eyal-Cohen, *supra* note 27, at 1045–46, 1087 (arguing that small business favoritism is inconsistent, over-inclusive, and creates data distortion); Douglas Holtz-Eakin, *Should Small Businesses Be Tax-Favored?*, 48 NAT'L TAX J. 387, 393 (1995) (concluding that for various reasons small business should not systematically be favored); Richard J. Pierce, Jr., *Small Is Not Beautiful: The Case Against Special Regulatory Treatment of Small Firms*, 50 ADMIN. L. REV. 537, 542–43 (1998) (providing a list of negative externalities small business creates in society); Eric Toder, *Does the Federal Income Tax Favor Small Business?*, 2007 NAT'L TAX ASSOC. PROC. 159, 159, http://www.ntanet.org/images/stories/pdf/proceedings/07/018.pdf [https://perma.cc/KLF8-7ERB] (arguing against the Internal Revenue Code favoring firms of different sizes); Wilson, *supra* note 65, at 68 (estimating that the cost of annually subsidizing small business is $5 billion).

[344] For example, the Joint Committee on Taxation and the Treasury Department's Office of Tax Analysis estimated the federal revenue cost of all the small business tax preferences to exceed $11 billion in fiscal year 2013. *See* GARY GUENTHER, CONG. RESEARCH SERV., RL32254, SMALL BUSINESS TAX BENEFITS: CURRENT LAW AND MAIN ARGUMENTS FOR AND AGAINST THEM (2013); *see also* ROBERT JAY DILGER, CONG. RESEACH SERV., R40985, SMALL BUSINESS: ACCESS TO CAPITAL AND JOB CREATION (2015) (recommending the federal government take certain actions to enhance small business access to capital).

[345] *See* Holtz-Eakin, *supra* note 343, at 387 (asserting that constructing a case of systematic favoritism of small businesses is quite difficult, especially through the tax code); *see also* Wilson, *supra* note 65, at 68 (estimating the cost of annually subsidizing small business to be $5 billion); *supra* Part III (describing Congress's history with small businesses).

[346] *See* J. COMM. ON TAXATION, 113TH CONG., REPORT TO THE HOUSE COMMITTEE ON WAYS AND MEANS ON PRESENT LAW AND SUGGESTIONS FOR REFORM SUBMITTED TO THE TAX REFORM WORKING GROUPS 551 (Comm. Print 2013), https://www.jct.gov/publications.html?func=startdown&id=4517 [https://perma.cc/3K9N-SJ54] ("Support expanding the cash method of accounting such that the gross receipts test would be increased from $5 million to $10 million . . . .").

[347] PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM, *supra* note 30, at 7, 9; *see also* GARY GUENTHER, CONG. RESEARCH SERV., RL31852, SMALL BUSINESS EXPENSING ALLOWANCE: CURRENT LAW, LEGISLATIVE PROPOSALS IN THE 112TH CONGRESS, AND ECONOMIC EFFECTS (2011), http://biblio.pennyhill.com/small-business-expensing-allowance-current-law-legislative-proposals-in-the-112th-congress-and-economic-effects/ [http://web.archive.org/web/20160427214031/http://biblio.pennyhill.com/small-business-expensing-allowance-current-law-legislative-proposals-in-the-112th-congress-and-economic-effects/]. President Obama proposed to allow businesses of all sizes to expense all qualifying capital expenditure with 100% bonus depreciation.

years there has been little empirical analysis of the efficacy of immediate expensing in spurring new investments.[348]

The merits of investment tax incentives continue to be debated.[349] Economist E. Cary Brown has long demonstrated that if we allow taxpayers to accelerate the recovery of their capital investments, their effective tax rates on income from those investments will be zero if they have sufficient income from other sources to absorb the deduction.[350] Scholars today echo the Brown theorem that the theoretical equivalence of these incentives, under certain assumptions, is exempting investments from tax altogether.[351] They argued that expensing has the effect of making the government a partner in taxpayers' investments[352] and change the balance between supply of, and demand for, investment projects.[353] The Congressional Research Service recently stated that capital investment incentives have the potential to restrain economic growth. It thus encouraged a greater flow of capital into investments that may produce lower returns than investments not favored by these incentives.[354]

This Article hopes to instigate further discussions on the effectiveness of historically perpetuated tax investment incentives in achieving their

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[348] A recent study on the effectiveness of investment tax incentives in spurring investments remains inconclusive. *See* GUENTHER, *supra* note 12 (concluding that available evidence indicates that the expensing allowances probably have had no more than a minor effect on business investment).

[349] *See, e.g.*, Thomas Gryta, *AT&T, Verizon Tax Breaks Fail to Produce Jobs*, WALL ST. J. (Dec. 11, 2014), http://www.wsj.com/articles/at-t-verizon-tax-breaks-fail-to-produce-jobs-1418345589 [http://web.archive.org/web/20160210002331/http://www.wsj.com/articles/at-t-verizon-tax-breaks-fail-to-produce-jobs-1418345589] ("With Congress poised to extend a raft of tax breaks, consider this: One such break has helped AT&T and Verizon slash their recent tax bills by billions of dollars without leading to the intended increase in investment or jobs.").

[350] E. Cary Brown, *Business-Income Taxation and Investment Incentives*, *in* INCOME, EMPLOYMENT AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSON 300 (1948).

[351] *Id.*; *see also* SETO, *supra* note 37, at 265; Shaviro, *supra* note 14, at 15 ("[W]hen the tax system simultaneously favors returns from business investment and permits interest expense deductions, taxpayers are encouraged to engage in tax arbitrage transactions, pairing tax-favored returns against fully deductible interest, that either may be shams, or else may be very poor investments that lose money before tax." (footnote omitted)).

[352] SETO, *supra* note 37, at 265. Similarly, Professor Johnson argued that investment incentives allow for the cost of the capital investment to go untaxed. This ability to make or continue investments with pretax "soft money" is an extraordinary privilege. *See* Calvin H. Johnson, *Soft Money Investing Under the Income Tax*, 1989 U. ILL. L. REV. 1019, 1020 ("Soft money investing is inconsistent with taxing the income from an investment."); *see also* Auerbach, *supra* note 24, at 1346–48 (demonstrating in tables 5 and 6 that the present value of accelerated cost recovery system deductions, plus the investment credit on a $1 investment, was greater than $1, producing a negative effective tax rate).

[353] *See* Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905, 1938 (1987) ("[C]ritics of certain capital recovery rules have argued that such rules distort the balance of investment in short-lived as opposed to long-lived assets . . . ." (citing Auerbach, *supra* note 24, at 1346–49)); Calvin H. Johnson, *Depreciation Policy During Carnival: The New 50 Percent Bonus Depreciation*, 100 TAX NOTES 713, 714 (2003) ("The prevailing interest rate measures the price of capital, as determined by the battle between the supply of capital from savings and the demand for capital from investment projects.").

[354] GUENTHER, *supra* note 347, at 27–28.

intended purpose. Wilbur Mills strongly contested the use of the tax system to affect investment behavior without proper accountability.[355] As time passes, he argued, it is essential that measures be tested against their intended goals.[356] Stanley Surrey echoed this notion in his proposal to display and reassess each year the magnitude of the tax expenditure budget.[357] It is time we reexamined the equitability and desirability of the abundance of tax incentives in the Code. Future studies should evaluate their effectiveness as economic catalyst, compared to other direct alternatives.

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[355] *See* Wilbur D. Mills, *Some Dimensions of Tax Reform*, 23 ARK. L. REV. 159, 161 (1969) ("[T]ax provisions adopted in the past to serve specific needs or purposes [must] be reviewed periodically to determine their propriety and usefulness in today's world."); *see also* JULIAN E. ZELIZER, TAXING AMERICA: WILBUR D. MILLS, CONGRESS, AND THE STATE, 1945–1975, at 15, 180 (1998) (portraying Mills as the most influential chair of the House Ways and Means Committee); Kirk J. Stark, *The Elusive Transition to a Tax Transition Policy*, 13 AM. J. TAX POL'Y 145, 166 (1996) (describing Mills as the powerful chair of the House Ways and Means Committee, the strongest committee in Congress).

[356] Mills, *supra* note 355, at 161 ("They must be tested against the criteria and standards of present-day society and current concepts and practices in the commercial and financial arenas.").

[357] *See generally* STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973); Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970).

APPENDIX

FIGURE I

Historical Maximum Allowance and Investment Limitations of Immediate Expensing from 1958 to 2014

Year	*Maximum Expensing Allowance*	*Maximum Cost of New Equipment*
1958–1981	20%	$10,000
1982	$5,000	---
1983	$5,000	---
1984	$7,500	---
1985	$5,000	---
1986	$5,000	---
1987–1992	$10,000	$200,000
1993–1996	$17,500	$200,000
1997	$18,000	$200,000
1998	$18,500	$200,000
1999	$19,000	$200,000
2000	$20,000	$200,000
2001–2002	$24,000	$200,000
2003	$100,000	$400,000
2004	$102,000	$410,000
2005	$105,000	$420,000
2006	$108,000	$430,000
2007	$125,000	$500,000
2008–2009	$250,000	$800,000
2010–2014	$500,000	$2,000,000

FIGURE II

Investment Tax Credit 1962–1986

Year	*Rate*	
1962	7%	
1963	7%	
1964	7%	
1965	7%	
1966	7%	Suspended October 10, 1966–March 9, 1967[358]
1967	7%	
1968	7%	
1969	Repealed	Effective April 18, 1969[359]
1970	---	
1971	7%	Reinstated June 23, 1971[360]
1972	7%	
1973	7%	
1974	7%	
1975	10%	Effective January 21, 1975[361]
1976	10%	
1977	10%	
1978	10%	
1979	10%	
1980	10%	
1981	10%	
1982	10%	
1983	10%	
1984	10%	
1985	10%	
1986	Repealed	Effective January 1, 1986[362]

[358] Act of June 13, 1967, Pub. L. No. 90-26, § 1, 81 Stat. 57, 57 (repealing suspension of credit for property purchased after March 9, 1967); Act of Nov. 8, 1966, Pub. L. No. 89-800, 80 Stat. 1508, 1509.

[359] Tax Reform Act of 1969, Pub. L. No. 91-172, § 703, 83 Stat. 487, 660–67.

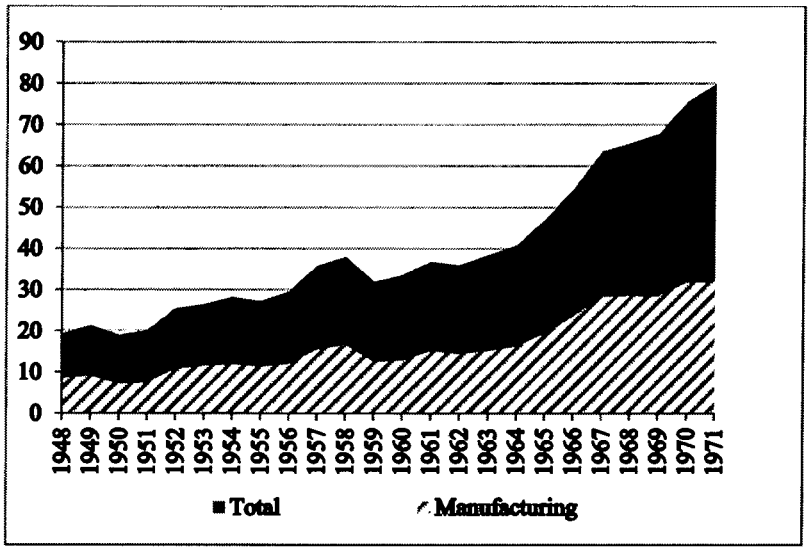
[360] Revenue Act of 1971, Pub. L. No. 92-178, § 101, 85 Stat. 497, 498–99.

[361] Tax Reduction Act of 1975, Pub. L. No. 94-12, § 301, 89 Stat. 26, 36; Tax Reform Act of 1976, Pub. L. No. 94-455, § 801, 90 Stat. 1520, 1580–81 (describing Congress's extension of the credit for four more years).

[362] Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, 2166.

FIGURE III

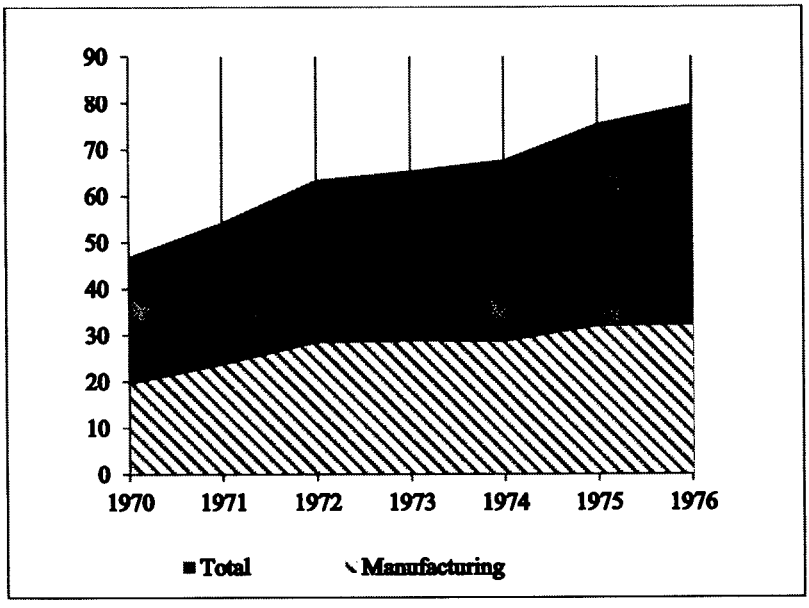
Business Expenditures for New Plant and Equipment 1948–1971 (in billions of dollars)[363]



[363] U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 1976, at 513 (1976), http://www2.census.gov/library/publications/1976/compendia/statab/97ed/1976-06.pdf [https://perma.cc/9X2G-XTKB]; U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 1967, at 30 (1967), https://fraser.stlouisfed.org/docs/publications/ei_supp/pages/606_1965-1969.pdf [https://perma.cc/3QXM-Q7T2].

FIGURE IV

Business Expenditures for New Plant and Equipment 1970–1976 (in billions of dollars)[364]



[364] *Id.*