

Anthony P. Curatola, Editor

By A.J. Cataldo, II, CMA, CPA, and Anthony P. Curatola

# Will Cash for Clunkers “Trickle Up”?

Even though the funds for the Cash for Clunkers program were consumed in a single month, the program wasn't extended. While it's still too early to gauge whether the program was a success, it may be helpful to place the program within a proper historical context.

The Obama administration's Cash for Clunkers program hasn't been extended despite the consumption of the entire amount appropriated during the single month of July 2009. While opinions may vary with respect to the success achieved by this novel program, some historical perspective on alternative, targeted, and stimulus-based strategies may warrant review.

## Early History of Depreciation

During the early years of U.S. corporate (starting 1909) and individual (starting 1913) taxation, little guidance existed for the selection of appropriate depreciable lives for capital assets. Following passage of the 16th Amendment (February 25, 1913), specific guidelines still weren't imposed for the useful lives of assets (or classes of assets) to compute depreciation deductions and taxable income. The U.S. Treasury Department refused to

announce or approve any fixed rates of depreciation, properly holding that the rate must in each case depend on the “facts and circumstances” and that any proposed rates were merely suggestive of the proper allowance for physical exhaustion—not including obsolescence—under average conditions.

In 1920, the Treasury Department's Bureau of Internal Revenue first published *Bulletin “F,”* revised in 1928, 1931, 1942, and 1955. It provided taxpayers with the current “practice” or “trend and tendency” for the depreciable lives for various classes of assets. The determination of the appropriate depreciable life and/or method remained a matter of taxpayer judgment.

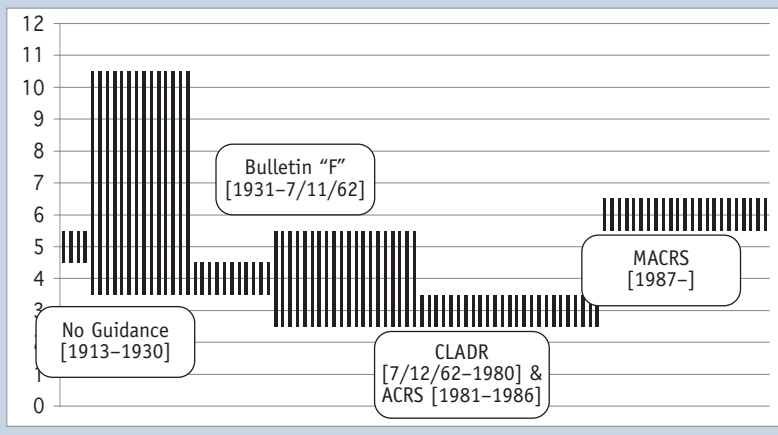
The post-1961 period marked the initial steps toward increasingly restrictive “guidance” to the taxpayer. It began with the reserve ratio (RR; 1962-70), followed by the class-life asset depreciation range (CLADR, 1971-80). The RR test provided the taxpayer with the means of computing an “upper limit” for annual depreciation charges. The CLADR system provided both upper and lower limits for depreciation and suggested guideline periods for

depreciable lives, as well as annual repair allowance percentages.

## Reagan Administration Tax Policy

The Reagan administration (1981-1989) used supply-side, trickle-down economics, lower tax rates, and shorter depreciable lives for long-lived assets to stimulate demand for automobiles (three years) under the Economic Recovery Tax Act (ERTA81). In 1986, the brakes were put on the plan with the Tax Reform Act of 1986 (TRA86) by increasing the depreciable lives for automobiles to six years (as a result of the half-year convention). This legislation led to increased automobile sales in December 1986 and decreased sales in January through March 1987 because small businesses, in anticipation of modified ACRS (MACRS) rules, accelerated their purchase of vehicles sales that might have otherwise been made during the first quarter of 1987 under the accelerated cost recovery system (ACRS). Taxpayers rushed to make early purchases and lock in the three-year depreciable life for their business-use automobiles. Figure 1 summarizes the entire U.S. history of depreciable lives for business-use vehicles (1913-2009).

**Figure 1. Depreciable Lives for Business Use Automobiles, 1913–2009**



**Reagan’s Supply-Side Trickle-Down Theory**

ERTA81 introduced ACRS for assets placed in service after 1980, replacing the CLADR and “facts and circumstances” depreciation methods. Depreciable lives of assets were no longer a function of a CLADR but were determined by law or by “statute.” ACRS provided “cost recovery.” For the first time in history, tax depreciation policy no longer attempted to match the useful life of an asset to the accounting period benefiting from its use for tax purposes. This was a significant event, with economic, fiscal, and economic governmental objectives now preempting accounting practice and tax regulations. The investment tax credit and the IRC §179 expensing election (starting in 1982), designed to replace its predecessor—bonus depreciation (1958-1980)—stimulated demand for automobiles, among other long-lived assets. The IRC §179 expense election had an “investment ceiling” designed to ensure that only small businesses benefitted.

MACRS (which began in 1987)

provided for longer depreciable lives for most assets. Congress was more concerned at that time with raising revenues than with stimulating the economy. Again, it was politics and not accuracy in accounting that drove the policy. Longer recovery periods for MACRS and the listed property limitations resulted in significantly slower depreciation than ACRS and, therefore, a higher taxable income each year. Taxpayer anticipation of a longer depreciable life for automobiles led to increased December 1986 unit sales, with the elimination of the sales tax credit also serving to stimulate demand for the nonbusiness automobile segment. This December 1986 deadline, however, robbed sales from the first three to four months of 1987 as increased late-1986 sales represented accelerated purchase decisions by all classes of taxpayers.

**How Does Cash for Clunkers Differ?**

The Obama administration’s Cash for Clunkers program appears to have been a huge success, but it

hasn’t been extended. The \$1 billion (less \$50 million for administration) divided by a maximum subsidy of \$4,500 per vehicle appears to have resulted in a minimum increase of 210,000 unit sales for July 2009 (\$950 million / \$4,500). The program required disclosure of the scrap value of the trade-in to purchasers of new vehicles and required the destruction of these less-fuel-efficient engines and drive trains.

The other difference between the Obama and Reagan solutions is the cash flow impact. Under the Cash for Clunkers program, the cash outflow and additional U.S. debt increase or impact were immediate. The Reagan administration’s traditional fiscal-policy-based approach deferred the cash outflow (in the form of a reduction in future tax revenue inflows) and, therefore, the immediate need for additional liquidity and borrowings from China, Russia, Brazil, and other international trading partners already concerned about increasing debt levels maintained by the U.S.

**Did Cash for Clunkers Succeed?**

The efficiency and effectiveness of the Cash for Clunkers program will be examined and reexamined for years. In terms of a market reaction, the fact that the entire appropriated amount was consumed in a single month (July 2009) suggests success because the desired reaction was achieved. Cash for Clunkers sales were targeted to stimulate demand from consumers. On one hand, it did. On the other hand, it has a long-term benefit of lower energy

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## Taxes

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consumption, which may or may not be realized. The program certainly requires, and undoubtedly will receive, further examination—and in an historical context. **SF**

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