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# Economic Implications for Arkansas Agriculture of State-Level Adoption of Section 179 Rules

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After closing the 2022 fiscal year with a state budget surplus of more than $1.6 billion, Arkansas Governor Asa Hutchinson reached an agreement with the General Assembly on tax cuts during a special session held the week of Aug. 8, 2022 (Arkansas Governor's Office, 2022). In particular, business income tax rules for depreciation expense defined under Section 179 of the Internal Revenue Code (IRC) were adopted as state policy in Arkansas. The current Section 179 depreciation expense election under the federal rules allows for up to a $1,050,000 deduction with a phase-out beginning at $2,620,000 (26 U.S.C. § 179) for the 2021 tax year. That is, if the 2021 purchase price is $3,670,000 or more, one cannot elect the Section 179 deduction.

Arkansas' former depreciation expensing rules differed from the Tax Cuts and Jobs Act of 2017 (TCJA) but allowed for a deduction of as much as $25,000 with a phase-out beginning at $200,000. In other words, if the 2021 purchase price for a piece of equipment was less than $225,000, some of the purchase price could have been deducted from a taxpayer's taxable income. For example, if a soybean farmer wanted to buy a new or used combine priced at or above $225,000, they would not have been able to elect the deduction for any portion of the purchase price. Given the current state of the agricultural economy with record input costs, producers are operating with thin margins, making this investment decision one that could be put off at a time when a purchase may be needed.

Arkansas is one of 10 states that have fully adopted the federal rules on deducting depreciation expense (Figure 1). Only 17 states have at least some level of conformity[1] to the federal deduction outlined under Section 179, which may be driven by a given state's choice to adopt the federal corporate income tax rules (Figure 1). States with laws allowing for rolling conformity to federal income tax laws will at least partially enforce at the state level whatever corporate income tax law is put into place at the federal level. Among the states that border Arkansas, Louisiana, Missouri, Oklahoma, and Tennessee have rolling conformity status.

While there are no peer-reviewed studies measuring the impact of Section 179 adoption on investment and employment in agriculture, there has been work that looks

**Footnote**
[1]The Tax Foundation groups the state-level degree of conformity to the Section 179 expensing rules into three categories: Rolling Conformity, Static Conformity, and Selective Conformity. Rolling Conformity describes states who automatically carry out tax changes at the federal-level as they are enacted. Static Conformity is similar to Rolling Conformity but only mirrors the Internal Revenue Code as it were at a certain point in time not on a rolling basis. Selective Conformity describes a state who choose only portions of the IRC and may leave out large segments. For a more detailed description of each type of conformity, visit taxfoundation.org.

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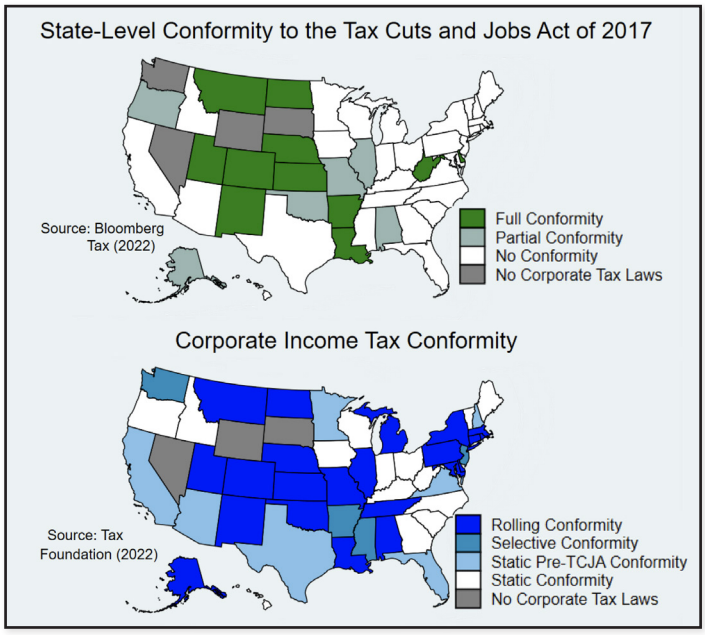
**Figure 1. The Association Between Section 179 Adoption and Corporate Income Tax Conformity.**




at impacts across other industries[2] in the United States (Garett, et al., 2019 and Ohrn, 2019). These studies point out three economic insights regarding the implications of Section 179 adoption. First, states that at least partially conform to the federal corporate income tax rate tend to partially adopt the provisions of the TCJA. Second, increasing the deduction limit for depreciation expense increases investment, which may or may not lead to job creation and wage growth. Third, the effect of increasing the tax deduction on job creation and wage growth depends on the relationship between capital and labor in a given industry. These studies show that if labor and capital are complementary, these incentives lead to job creation and possible wage growth. Conversely, these same studies show that if capital and labor are substitutes, then these incentives may lead to less job creation or even a "crowding out" of labor, with technology replacing the need for labor in certain industries and regions.

The tax incentives discussed here are generally a means to an end, which is to increase investment and stimulate economic activity through job creation and wage growth. However, that impact will vary depending on the relationship[3] between capital and labor. In agriculture, the share of total employment has steadily decreased across time with the most recent figure stating U.S. agricultural employment consists of 2 percent of total employment (Bureau of Labor Statistics, 2018). With the fall in farm labor and growing demand for food, the U.S. agricultural sector is having to rely more on capital and technology improvement to continue producing at the same rate as it has over time (Wang, et al., 2022). Therefore, depending on the relationship between on-farm labor and capital employed in the agricultural production process, adopting TCJA expensing rules defined under Section 179 of the IRC could result in maintaining production levels and possible changes in employment leading to farm income stability.

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**Footnotes**

[2]The works of Garrett, et al. (2019) and Ohrn (2019) use industries listed in the North American Classification System (NAICS).

[3]Hamilton, et al. (2021) find that farmers have an incentive to invest more in capital when capital and labor are substitutes and will invest in less capital when they are complementary factors of production in the context of strawberry production in California.


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