Tax Incentives, Small Businesses, and Physical Capital Reallocation

Abstract

We provide new evidence on the spillover effect of temporary federal tax incentives. Using granular data on equipment purchases, we find that tax subsidies on new equipment investment via accelerated depreciation increase small business investment in used capital by 9.2%. This spillover effect arises as some direct beneficiaries replace their used capital with new capital, causing a reduction in the prices of old equipment. This further enables small businesses entry, adoption of new technology, and accelerated growth. Our empirical results underscore how tax incentives driving investment in new capital goods foster the reallocation of used capital goods within the economy during recessions.