

COMPARISON OF PRESENT LAW AND ADMINISTRATION'S  
CAPITAL COST RECOVERY PROPOSAL

Joint Committee on Taxation  
February 24, 1981  
JCX-5-81

| <u>Item</u>  | <u>Present law</u>  | <u>Administration proposal</u>   |
|--|---|--|
| 1. <u>Underlying concept</u>   |   |  |
| (Depreciation deduction allowed for decline in value of capital assets (other than land) from wear and tear or obsolescence) | Designed to spread depreciation deductions over period asset used in business so that deductions for cost of asset are matched with the income produced by the use of the asset           | Cost of assets recovered over short, predetermined periods unrelated to useful lives (or income produced by use of asset) in order to stimulate investment in productive assets  |
| 2. <u>Useful lives (recovery periods) and methods</u>  |   |  |
| A. <u>In general</u>   | Taxpayer uses (1) either life based on "facts and circumstances" or guideline life set by the IRS (including ADR variances), and (2) either straight-line or certain accelerated methods. | Mandatory recovery period and accelerated method specified for most tangible property.<br>(Proposed system does not apply to property depreciated in terms other than years (except certain railroad property) or amortized (e.g., leaseholds).) |



| <u>Item</u>   | <u>Present law</u>                       |   | <u>Administration proposal</u> |  |
|---|--|---|--------------------------------|--|
|   | <u>Permitted ADR lives</u> <sup>1/</sup> | <u>Methods permitted</u> <sup>2/</sup>  | <u>Recovery period</u>         | <u>Method</u>  |
| B. <u>Personal property</u>                                     |  |   |                                |  |
| Autos, light-duty trucks  | 2.5 - 5 years <sup>3/</sup>              | New property--straight-line, 200% declining balance, and sum-of-the-years digits ("SYD"). Used property--straight-line only | 3 years                        | Mandatory accelerated rate prescribed--equal to 200% declining balance in early years with a change to SYD in later years to maximize acceleration |
| R&D equipment   | Same as other equipment                  | Same as above   | 3 years                        | Same as above  |
| Long-lived public utility property                              | 14.5 - 60 years <sup>3/</sup>            | Same as above   | 10 years                       | Same as above  |
| Other equipment (including short-lived public utility property) | 2 - 36 years <sup>3/</sup>               | Same as above   | 5 years                        | Same as above  |

1/ Under the ADR system, the IRS, on the basis of actual industry experience, specifies a mid-point life for equipment used in most industries; taxpayers may elect lives 20% longer or shorter than the mid-point life.

2/ Straight-line allows a deduction ratably over useful life; accelerated methods such as declining balance and sum-of-the-years digits allow larger deductions in earlier years and smaller in later years.

3/ Permitted lives for specific property depends on type of property and type of industry. The periods shown in the table reflect the 20-percent variances allowed under the ADR system.



| Item  | <u>Present Law</u>                    | <u>Administration Proposal</u>  |                            |  |
|---|---------------------------------------|---|----------------------------|--|
| C. <u>Real property</u>                         | <u>IRS guideline<br/>useful lives</u> | <u>Methods<br/>permitted</u>  | <u>Recovery<br/>period</u> | <u>Methods permitted</u>   |
| Owner-occupied factories,<br>stores, warehouses | 45-60 years <u>4/</u>                 | Straight-line and,<br>if new, 150% declin-<br>ing balance or<br>SYD                     | 10 years                   | Statutory rate equal to<br>200% declining balance<br>in early years, changing<br>to SYD in later years to<br>maximize acceleration |
| Other nonresidential<br>property                | 40 - 50 years <u>4/</u>               | Same as above   | 15 years                   | Straight-line only   |
| Low-income housing                              | 40 - 45 years <u>4/</u>               | Straight-line or<br>125% declining<br>balance and, if<br>new, 200% declining<br>balance | 15 years                   | Straight-line only   |
| Other residential<br>property                   | 40 - 45 years <u>4/</u>               | Same as above   | 18 years                   | Straight-line only   |

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<sup>4/</sup> Taxpayers often use shorter useful lives either based on the facts and circumstances for a specific building or by using component depreciation.



| <u>Item</u>                                  | <u>Present law</u>   | <u>Administration proposal</u>   |
|--|--|--|
| 3. <u>Beginning of depreciation</u>          | Tax year property is placed in service   | Tax year property is placed in service,<br>or<br>tax year in which construction of property begins, if property has normal construction period of at least 2 years |
| 4. <u>Asset accounting</u>                   | Vintage accounts <u>5/</u>   | Vintage accounts <u>5/</u>   |
| 5. <u>Salvage value</u>                      | Property cannot be depreciated below estimated salvage value                       | Entire cost of recovery property is depreciated without regard to possible salvage value   |
| 6. <u>Additional first year depreciation</u> | Optional bonus depreciation<br>20% of property cost up to<br>\$10,000 per taxpayer | No bonus depreciation allowed for recovery property  |

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5/ Under vintage accounting, depreciation allowable, gain on disposition, and recapture of depreciation on disposition are determined on an asset-by-asset basis. Assets are accounted for according to the year they were placed in service.





Item

Present law

Administration proposal

7. Disposition of assets

Gain or loss is recognized on sale or other disposition of an asset; allowable depreciation deductions reduce basis of property used in determining gain or loss on disposition

Same as present law

8. Recapture of depreciation

A. Personal property

Gain is ordinary income rather than capital gain to extent of prior depreciation allowable. (Sec. 1245 "recapture")

Same as present law (Sec. 1245 "recapture")

B. Real property

Gain is ordinary income rather than capital gain only to extent prior allowable depreciation exceeds what would have been allowable if straight-line used. (Sec. 1250 "recapture")

Section 1245 "recapture" for all 10-year property

No recapture on other real property.

9. Flexibility

a. Option to use useful lives 20% shorter or longer than ADR mid-point lives

Fixed recovery period for recovery property

b. Option to use straight-line or accelerated, where allowed

Fixed methods for recovery property

c. Required to deduct all depreciation allowable (i.e., no "banking"); net operating losses can be carried forward 7 years

As under present law, no "banking"; net operating loss carry-forward period extended to 10 years

d. Investment credit can be carried forward 7 years

Investment credit can be carried forward 10 years

e. Option to claim depreciation for one half-year on all property placed in service in tax year ("half-year convention") or full depreciation on property placed in service in first half of tax year and no depreciation on property placed in service in second half of tax year ("modified half-year convention")

Half-year convention built into proposed rates.



| <u>Item</u>   | <u>Present law</u>  | <u>Administration proposal</u>  |                                 |                               |                 |         |                 |          |                           |          |               |          |
|---|---|---|---------------------------------|-------------------------------|-----------------|---------|-----------------|----------|---------------------------|----------|---------------|----------|
| 10. <u>Earnings and profits (E&amp;P)</u><br><br>(Distributions to shareholders are taxable as dividends only to extent of earnings and profits. Depreciation deductions reduce E&P.) | Based on straight-line depreciation over useful life (including lower limit of permitted ADR lives) | Based on straight-line depreciation over extended recovery period as compared to recovery period used for taxable income<br><br><table><tr><td>If regular recovery period is--</td><td>Extended recovery period is--</td></tr><tr><td>3-year property</td><td>5 years</td></tr><tr><td>5-year property</td><td>10 years</td></tr><tr><td>10-year personal property</td><td>20 years</td></tr><tr><td>Real property</td><td>30 years</td></tr></table> | If regular recovery period is-- | Extended recovery period is-- | 3-year property | 5 years | 5-year property | 10 years | 10-year personal property | 20 years | Real property | 30 years |
| If regular recovery period is--   | Extended recovery period is--   |   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| 3-year property   | 5 years   |   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| 5-year property   | 10 years  |   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| 10-year personal property   | 20 years  |   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| Real property   | 30 years  |   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| 11. <u>Depreciation of assets held outside U.S.</u>   | Accelerated methods generally allowed<br><br>No variance from ADR mid-point life                    | Straight-line required<br><br>Extended recovery period required (same as periods used to compute E&P)   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| 12. <u>Minimum tax and maximum tax</u>  |   |   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| A. Assets subject to application of minimum tax   | Real property and leased personal property  | Leased personal property only   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| B. Amount of tax preference item  | Depreciation deductions in excess of amount allowable if straight-line used over actual useful life | Excess of allowable depreciation over amount allowable if straight-line were used over extended recovery period   |                                 |                               |                 |         |                 |          |                           |          |               |          |
| C. Amount of tax preference offset (reduces amount eligible for 50% maximum tax)  | Same as above   | Same as above   |                                 |                               |                 |         |                 |          |                           |          |               |          |



| <u>Item</u>                                   | <u>Present law</u>   | <u>Administration Proposal</u>   |
|---|--|--|
| <b>13. <u>Investment Tax Credit (ITC)</u></b> |  |  |
| <b>A, <u>Amount of credit</u></b>             | <b><u>Estimated Useful Life</u></b>  | <b><u>Credit (%)</u>      <u>Recovery Period</u>      <u>Credit (%)</u></b>  |
|   | 0 - 3 years  | -0-      3-year property      6  |
|   | 3 - 5 years  | 3-1/3      5-year and 10-<br>year property      10   |
|   | 5 - 7 years  | 6-2/3  |
|   | Over 7 years   | 10   |
| <b>B, <u>Recapture of credit</u></b>          | Credit recomputed on<br>early disposition as if<br>actual useful life<br>had been used to determine<br>amount of credit. | Credit recomputed<br>on early disposition by<br>allowing 2% credit for<br>each year held (no recapture if<br>property actually held for at least<br>5 years) |
| <b>14. <u>"At-risk" limitation</u></b>        |  |  |
| <b>A. Depreciation</b>                        | Loss generated by depre-<br>ciation limited if property<br>financed on a nonrecourse basis                               | Same as present law  |
| <b>B. Investment credit</b>                   | None   | Credit denied to extent property<br>financed on a nonrecourse basis  |



Effective date of Administration proposal

- A. In general--Applies to property placed in service in taxable years beginning after December 31, 1980.
- B. Transition rule (phase-in).--Annual election immediately to phase in first \$100,000 of 5-year property for each year of transition. As set out in the table below, 5-year and 10-year property have 4-year phase-in; 15-year property has 2-year phase-in. No phase-in for 3-year and 18-year property. Taxpayers may elect to use the 5-year recovery period without phase-in for the first \$100,000 of 5-year property for each year of phase-in.

| <u>Transition year</u> | <u>If lower limit of permitted<br/>ADR life is--</u> | <u>Recovery period is--</u> |
|------------------------|--|-----------------------------|
| 1981                   |  |                             |
| 5-year property        | 5.5 years or less                                    | 5 years                     |
|                        | 6.0 to 6.5 years                                     | 6 years                     |
|                        | 7.0 to 7.5 years                                     | 7 years                     |
|                        | 8.0 to 8.5 years                                     | 8 years                     |
|                        | 9.0 years or more                                    | 9 years                     |
| 10-year property       | All lives  | 18 years                    |
| 15-year property       | All lives  | 18 years                    |
| 1982                   |  |                             |
| 5-year property        | 6.5 years or less                                    | 5 years                     |
|                        | 7.0 to 7.5 years                                     | 6 years                     |
|                        | 8.0 to 8.5 years                                     | 7 years                     |
|                        | 9.0 or more years                                    | 8 years                     |
| 10-year property       | All lives  | 16 years                    |
| 15-year property       | All lives  | 16 years                    |
| 1983                   |  |                             |
| 5-year property        | 7.5 years or less                                    | 5 years                     |
|                        | 8.0 to 8.5 years                                     | 6 years                     |
|                        | 9.0 years or more                                    | 7 years                     |
| 10-year property       | All lives  | 14 years                    |
| 1984                   |  |                             |
| 5-year property        | 8.5 years or less                                    | 5 years                     |
|                        | 9.0 years or more                                    | 6 years                     |
| 10-year property       | All lives  | 12 years                    |

