

**DESCRIPTION OF H.R. 765, THE
“RESTAURANT AND RETAIL JOBS AND GROWTH ACT”**

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on September 17, 2015

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



September 16, 2015
JCX-118-15

CONTENTS

	<u>Page</u>
INTRODUCTION	1
A. Making Permanent 15-year Straight-Line Cost Recovery for Qualified Leasehold Improvements, Qualified Restaurant Buildings and Improvements, and Qualified Retail Improvements	2
B. Estimated Revenue Effects	5

INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 765, the “Restaurant and Retail Jobs and Growth Act,” a bill to permanently extend the 15-year recovery period for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, for September 17, 2015. This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 765, the “Restaurant And Retail Jobs And Growth Act,”* (JCX-118-15), September 16, 2015. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

A. Making Permanent 15-year Straight-Line Cost Recovery for Qualified Leasehold Improvements, Qualified Restaurant Buildings and Improvements, and Qualified Retail Improvements

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (“MACRS”), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.² The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year in which property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2015. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.³ The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which

² Sec. 168.

³ Sec. 168(e)(6).

the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.⁴ If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement.⁵ An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.⁶

Qualified leasehold improvement property is generally recovered using the straight-line method and a half-year convention.⁷ Qualified leasehold improvement property placed in service after December 31, 2014 is subject to the general rules described above.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2015. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.⁸ Qualified restaurant property is recovered using the straight-line method and a half-year convention.⁹ Additionally, qualified restaurant property is not eligible for bonus depreciation unless it also satisfies the definition of qualified leasehold improvement property.¹⁰ Qualified restaurant property placed in service after December 31, 2014 is subject to the general rules described above.

Qualified retail improvement property

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property placed in service before January 1, 2015. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public¹¹ and is used in the retail trade or business

⁴ Sec. 168(e)(6) and (k)(3).

⁵ Sec. 168(e)(6)(A).

⁶ Sec. 168(e)(6)(B).

⁷ Sec. 168(b)(3)(G) and (d). An additional first-year depreciation deduction ("bonus depreciation") is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service before January 1, 2015 (January 1, 2016 for certain longer-lived and transportation property). See sec. 168(k). Qualified property eligible for bonus depreciation includes qualified leasehold improvement property. Sec. 168(k)(2)(A)(i)(IV).

⁸ Sec. 168(e)(7).

⁹ Sec. 168(b)(3)(H) and (d).

¹⁰ Sec. 168(e)(7)(B).

¹¹ Improvements to portions of a building not open to the general public (e.g., stock room in back of retail space) do not qualify under the provision.

of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.¹² Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.¹³ In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.¹⁴

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.¹⁵

Qualified retail improvement property is recovered using the straight-line method and a half-year convention.¹⁶ Additionally, qualified retail improvement property is not eligible for bonus depreciation unless it also satisfies the definition of qualified leasehold improvement property.¹⁷ Qualified retail improvement property placed in service after December 31, 2014 is subject to the general rules described above.

Description of Proposal

The proposal makes permanent the present-law provisions for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

Effective Date

The proposal is effective for property placed in service after December 31, 2014.

¹² Sec. 168(e)(8).

¹³ Sec. 168(e)(8)(C).

¹⁴ Sec. 168(e)(8)(B). Rules similar to section 168(e)(6)(B) apply in the case of death and certain transfers of property that qualify for non-recognition treatment.

¹⁵ Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress* (JCS-1-09), March 2009, p. 402.

¹⁶ Sec. 168(b)(3)(I) and (d).

¹⁷ Sec. 168(e)(8)(D).

B. Estimated Revenue Effects

Fiscal Years											
[Millions of Dollars]											
<hr/>											
<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2016-20</u>	<u>2016-25</u>
-585	-960	-1,481	-2,020	-2,550	-3,078	-3,627	-4,180	-4,739	-5,207	-7,596	-28,427

NOTE: Details do not add to totals due to rounding.