

## Depreciation – Leasehold Improvements

### **What is the issue and current law? When was this provision put in the tax code?**

Until 2004 the Internal Revenue Code required that depreciation for leasehold or tenant improvements (TI) occur over the economic life of the building structure itself - 39 years, rather than over the economic life of the improvements. In 2004, tax legislation was enacted that temporarily reduced this 39-year depreciation period for TI to 15 years - a period more reflective of the true economic life of TI in the modern commercial real estate market. The current 15-year depreciation schedule for qualified leasehold improvements must be reauthorized yearly in what has become known as “tax extenders legislation”, or it will automatically revert to a 39-year depreciation schedule.

In 2011, these provisions expired, and were only extended for 1 year after passage of H.R. 8, *The American Taxpayer Relief Act of 2012*, (the “Fiscal Cliff” legislation) signed into law on January 2nd by President Obama.

### **Why was it put in the tax code?**

Congress has recognized that requiring property owners to amortize the costs for tenant improvements over a recovery period that has no relation to the economic life of the assets makes no sense. This artificially depresses rates of return. Correcting the depreciation rules and the tenant improvement amortization rules allows upgrades for technology and modernization to be more economically feasible. These types of improvements assure that nonresidential buildings will be adequately maintained and remain technologically current. Updated and well-maintained properties are more readily bought and sold, spurring economic growth.

### **What would be the impact on those Americans if the provision were changed or eliminated?**

Longer depreciation periods result in longer recovery times and less of a return on investment for building owners, creating disincentives for them to upgrade and modernize space for their tenants. Constant renewal of expiring tax provisions in annual tax extenders legislation has become more controversial and over the years has become politically more difficult, despite most of the provisions enjoying broad bipartisan support. Having to each year extend 15-year qualified leasehold improvement depreciation creates needless uncertainty for the commercial real estate industry, hindering our nation’s economic recovery.

NAR supports efforts to establish a *permanent* rule that more accurately reflects the depreciable lives of buildings and to conform amortization periods for tenant improvements more closely to the term of the lease. NAR supports the 15-year recovery period, but would eagerly support an even shorter term.