

NAR Issue Summary

Federal Tax / Depreciation -- Tenant (Leasehold) Improvements

NAR Committee:

Federal Taxation Committee

What is the fundamental issue?

A temporary provision permitting the cost of leasehold improvements to be recovered over 15 years has been in place for many years. Unfortunately, this provision was allowed to expire at the end of 2014. Thus, unless Congress extends the provision on a retroactive basis, for leasehold improvements placed in service on or after January 1, 2015, such costs will need to be recovered over a 39-year statutory life.

I am a real estate professional. What does this mean for my business?

Property owners are required to amortize the costs of improvements made on behalf of tenants over a recovery period that has no relation to the economic life of the assets. This artificially depresses rates of return. Providing a shorter and more realistic depreciation period for tenant improvements allows upgrades for technology and modernization to be more economically feasible. These types of improvements help assure that nonresidential buildings will be adequately maintained and remain technologically current. Updated and well-maintained properties are more readily bought and sold.

NAR Policy:

NAR supports efforts to establish a *permanent* rule that more accurately reflects the actual 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.

Even a 15-year recovery period for tenant improvements is longer than the term of a standard lease. Good tax policy dictates that the cost recovery period should approximate the economic life of the asset.

Opposition Arguments:

No one has put forward any valid policy arguments in opposition to NAR policy, and policymakers on both sides of the political aisle support a cost recovery period of no longer than 15 years. The difficulty in getting the 15-year recovery period enacted permanently has to do with the problems of finding ways to offset the cost to the Treasury and not to policy opposition.



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Legislative/Regulatory Status/Outlook

There is no controversy about the merits of the 15-year life for leasehold improvements. The provision has always been part of a larger legislative package driven by the need to extend expired or expiring provisions. Controversy on the so-called "extenders package" has usually been a matter of how to "pay for" it. However, with tax reform being discussed seriously in Congress, extending the expired or expiring provisions has taken a back seat to reform. Many observers believe that these provisions, including the one for leasehold improvements, may not be addressed by Congress before autumn 2015. Moreover, some believe that not all expired provisions will be automatically extended, as they have often been in the past. The leasehold improvements provision enjoys bipartisan support, so it may fare better in tax reform than other expired provisions. However, there is more doubt surrounding the long-term outlook for this issue than has existed in the recent past. NAR is continuing to work with Congress to permanently extend the 15-year cost recovery period for leasehold improvements. NAR is also continuing to urge Congress to pass legislation that would expand expensing rules to include leasehold improvements.

Current Legislation/Regulation (bill number or regulation)

H.R. 765, Restaurant and Retail Jobs and Growth Act
S. 394, Depreciation Fairness Act of 2015

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