108TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
108–755

AMERICAN JOBS CREATION ACT OF 2004

CONFERENCE REPORT

TO ACCOMPANY

H.R. 4520

OCTOBER 7, 2004.—Ordered to be printed

additional two years. Thus, the provision provides that the maximum dollar amount that may be deducted under section 179 is $100,000 for property placed in service in taxable years beginning before 2008 ($25,000 for taxable years beginning in 2008 and thereafter). In addition, the $400,000 amount applies for property placed in service in taxable years beginning before 2008 ($200,000 for taxable years beginning in 2008 and thereafter). The provision extends, through 2007 (from 2005), the indexing for inflation of both the maximum dollar amount that may be deducted and the $400,000 amount. The provision also includes off-the-shelf computer software placed in service in taxable years beginning before 2008 as qualifying property. The provision permits taxpayers to revoke expensing elections on amended returns without the consent of the Commissioner with respect to a taxable year beginning before 2008. The Committee expects that the Secretary will prescribe regulations to permit a taxpayer to make an expensing election on an amended return without the consent of the Commissioner.

Effective date.—The provision is effective on the date of enactment.

SENATE AMENDMENT

The provision provides that the $100,000 amount ($25,000 for taxable years beginning in 2006 and thereafter) is reduced (but not below zero) by only one half of the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000 ($200,000 for taxable years beginning 2006 and thereafter).[41]

For example, under the provision, if in 2004 an eligible taxpayer places in service qualifying property costing $500,000, the $100,000 amount is reduced by $50,000 (i.e., one half the amount by which the $500,000 cost of qualifying property placed in service during the taxable year exceeds $400,000). Thus, the maximum amount eligible for section 179 expensing by this taxpayer for 2004 is $50,000.

Effective date.—The provision is effective for taxable years beginning after December 31, 2002.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

B. DEPRECIATION

1. Recovery period for depreciation of certain leasehold improvements (sec. 211 of the House bill and sec. 168 of the Code)

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

[41] As a result of the reduced phase-out percentage, the deductible amount in the New York Liberty Zone, an enterprise zone or a renewal community is correspondingly increased. See sec. 1400L(f), sec. 1397A and sec. 1400J.

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 (sec. 168). 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 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

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.[42] This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service.[43] If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement 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.[44]

Qualified leasehold improvement property

The Job Creation and Worker Assistance Act of 2002[45] ("JCWAA"), as amended by JGTRRA, generally provides an additional first-year depreciation deduction equal to either 30 percent or 50 percent of the adjusted basis of qualified property placed in service before January 1, 2005. Qualified property includes qualified leasehold improvement property. For this purpose, qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. 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

[42] Sec. 168(i)(8). The Tax Reform Act of 1986 modified the Accelerated Cost Recovery System ("ACRS") to institute MACRS. Prior to the adoption of ACRS by the Economic Recovery Tax Act of 1981, taxpayers were allowed to depreciate the various components of a building as separate assets with separate useful lives. The use of component depreciation was repealed upon the adoption of ACRS. The Tax Reform Act of 1986 also denied the use of component depreciation under MACRS.

[43] Former sections 168(f)(6) and 178 provided that, in certain circumstances, a lessee could recover the cost of leasehold improvements made over the remaining term of the lease. The Tax Reform Act of 1986 repealed these provisions.

[44] Secs. 168(b)(3), (c), (d)(2), and (i)(6). If the improvement is characterized as tangible personal property, ACRS or MACRS depreciation is calculated using the shorter recovery periods, accelerated methods, and conventions applicable to such property. The determination of whether improvements are characterized as tangible personal property or as nonresidential real property often depends on whether or not the improvements constitute a "structural component" of a building (as defined by Treas. Reg. sec. 1.48–1(e)(1)). See, e.g., *Metro National Corp* v. *Commissioner,* 52 TCM (CCH) 1440 (1987); *King Radio Corp Inc.* v. *U.S.,* 486 F.2d 1091 (10th Cir. 1973); *Mallinckrodt, Inc.* v. *Commissioner,* 778 F.2d 402 (8th Cir. 1985) (with respect to various leasehold improvements).

[45] Pub. L. No. 107–147, sec. 101 (2002), as amended by Pub. L. No. 108–27, sec. 201 (2003).

was first placed in service. Qualified leasehold 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.

Treatment of dispositions of leasehold improvements

A lessor of leased property that disposes of a leasehold improvement that was made by the lessor for the lessee of the property may take the adjusted basis of the improvement into account for purposes of determining gain or loss if the improvement is irrevocably disposed of or abandoned by the lessor at the termination of the lease. This rule conforms the treatment of lessors and lessees with respect to leasehold improvements disposed of at the end of a term of lease.

HOUSE BILL

The House bill provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2006.[46] The provision requires that qualified leasehold improvement property be recovered using the straight-line method.

Qualified leasehold improvement property is defined as under present law for purposes of the additional first-year depreciation deduction,[47] with the following modification. 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. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Effective date.—The House bill provision is effective for property placed in service after the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

2. Recovery period for depreciation of certain restaurant improvements (sec. 211 of the House bill and sec. 168 of the Code)

PRESENT LAW

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

[46] Qualified leasehold improvement property continues to be eligible for the additional first-year depreciation deduction under sec. 168(k).

[47] Sec. 168(k).