The Bankler Report

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INTRODUCTION

Congress greatly expanded depreciation deductions allowed for nonresidential real estate placed into service for taxable years beginning in 2016 with the enactment of Protecting Americans from Tax Hikes (PATH) Act, which was signed by President Obama on December 18, 2015.

Law Prior to 2016.

Generally, nonresidential real estate improvements are depreciated on the straight-line method over 39 years. Leasehold improvements are subject to the same depreciation rules regardless of whether the improvements are incurred by the real estate's owner or lessee. Further, these improvements are depreciated on the same 39-year straight-line amortization, regardless of the length of the lease. However, exceptions exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail property.

Basically, qualified leasehold improvement property is any improvement to an interior portion of a nonresidential building that meets the following requirements: (A) Improvements are made under or pursuant to a lease, (B) improvements are placed into service more than 3 years after the building was placed into service, (C) improvements cannot be made to (1) enlarge the building, (2) any elevator, (3) any escalator, (4) any structural component benefiting a common area or the internal structural framework of the building. Qualified leasehold improvements are depreciable using the straight-line method over 15 years. The improvements may also qualify for bonus depreciation.

Qualified restaurant property is a building or improvement to a building, if more than 50% of the square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals. Qualified property is depreciable also using the straight-line method over 15 years. If improvements also qualify as qualified leasehold improvements (above), then they may also qualify for bonus depreciation.

Qualified retail improvement property is any improvement to an interior portion of a nonresidential building, if such portion is: (A) open to the general public, (B) used in the retail trade or business of selling tangible personal property to the general public, (C) placed into service more than 3 years after the building was placed into service, (D) not made to (1) enlarge the building, (2) include any elevator, (3) include any escalator, (4) include any structural component benefiting a common area or the internal structural framework of the building. Qualified retail improvement property is depreciable using the straight-line method over 15 years. If improvements also qualify as qualified leasehold improvements (above), then it may also qualify for bonus depreciation.

Law in effect for 2016 and beyond.

Generally, the law makes permanent the 15-year depreciation allowance for all qualified improvements to nonresidential property. In addition, bonus depreciation (50% bonus in the first year) is now available for all improvements meeting the following conditions: (1) The improvements are placed into service after the date the building is placed in service (**no more waiting for 3 years!**), (2) the improvements are for interior portions of the buildings, and (3) the improvements still exclude the same components above (expansion, elevator, escalators, common areas, etc.)

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In addition, the election to expense rather than capitalize and depreciate certain qualified property (Section 179 election) includes these qualified improvements, up to $500,000. In addition, the law changes the definition of qualified property to now include heating and air-conditioning units.

Planning Tips.

Since qualified improvements can be made immediately after the building is placed into service, rather than the previous requirement requiring a 3-year waiting period, it is now possible for new construction to qualify. Working with your contractor, it might be possible to build a major portion of a building, place the building into service, and then proceed to construct qualified improvements. These improvements would then qualify for rapid depreciation (50% bonus depreciation, expensing election up to $500,000 and 15-year [rather than 39-year] depreciation deductions.)

Qualifying improvements made to newly acquired existing nonresidential real estate are easier to segregate, document, and deduct.

In all cases, construction costs need to be identified and separated (building [broken down by various costs] and qualified improvements) in order to take full advantage of this law change.

For more information or assistance, please feel free to contact us.

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