

deduction if the other requirements of section 168(k) are met (*i.e.*, improvements that constitute “qualified improvement property”).<sup>546</sup>

*Qualified improvement property*

Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.<sup>547</sup> Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

*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.<sup>548</sup> 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 to the 39-year recovery period 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. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.<sup>549</sup> 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 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. 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.

<sup>546</sup> Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See also section 13201 of the bill (Temporary 100-percent expensing for certain business assets).

<sup>547</sup> Sec. 168(k)(3).

<sup>548</sup> Sec. 168(i)(8).

<sup>549</sup> Sec. 168(e)(6).

Qualified leasehold improvement property is generally recovered using the straight-line method and a half-year convention,<sup>550</sup> and is eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met.<sup>551</sup>

*Qualified restaurant property*

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property. 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.<sup>552</sup> Qualified restaurant property is recovered using the straight-line method and a half-year convention.<sup>553</sup> Additionally, qualified restaurant property is not eligible for the additional first-year depreciation deduction unless it also satisfies the definition of qualified improvement property.<sup>554</sup>

*Qualified retail improvement property*

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property. 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 public<sup>555</sup> and is used in the retail trade or business 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.<sup>556</sup> 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.<sup>557</sup> 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.<sup>558</sup>

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-

<sup>550</sup> Sec. 168(b)(3)(G) and (d).

<sup>551</sup> Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See section 13201 of the bill (Temporary 100-percent expensing for certain business assets).

<sup>552</sup> Sec. 168(e)(7).

<sup>553</sup> Sec. 168(b)(3)(H) and (d).

<sup>554</sup> Sec. 168(e)(7)(B).

<sup>555</sup> 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.

<sup>556</sup> Sec. 168(e)(8).

<sup>557</sup> Sec. 168(e)(8)(C).

<sup>558</sup> 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.