TAXATION OF QUALIFIED IMPROVEMENT PROPERTY

OBJECTIVE: Fix a drafting error in the Tax Cuts and Jobs Act (Public Law No: 115-97), and allow interior improvements to commercial buildings, known as qualified improvement property, to be eligible for 100 percent bonus depreciation.

BACKGROUND: The Tax Cuts and Jobs Act (TCJA) aimed to spur investment in upgrades and improvements to commercial properties by making qualified improvement property or "QIP" (generally, improvements to the interior of existing nonresidential buildings) eligible for accelerated bonus depreciation and subject to a 15-year depreciation recovery period.

However, the tax law mistakenly excludes many interior improvements to commercial buildings from 100 percent bonus depreciation and are required to be written off over time periods as long as 39 years. This exclusion is widely believed to have been due to a legislative oversight. Congress seems to have intended building improvements to be eligible for 100 percent bonus depreciation, but left them out due to a last-minute drafting error. As a result, the new tax law actually worsens the tax treatment of this type of investment, which previously qualified for bonus depreciation, by reducing the ability of businesses to deduct their full building improvement costs.

Under current law, businesses investing in upgrades are worse off from a cash flow and tax exposure perspective than they were prior to tax reform (when 50 percent bonus depreciation would have applied to all QIP, and restaurant, retail and leasehold properties would have had a 15-year recovery period). To put this into perspective, instead of being able to write off 100 percent of these investments under the TCJA's accelerated bonus depreciation provisions or approximately 47 percent under pre-tax reform law, businesses are only able to write off *2.5* percent this year and then depreciate the remainder over the next *38 years*.

Cost Recovery for QIP			
Depreciation Allowances for a $100 Investment			
	Prior Law	**Intent of TCJA**	**Current Law**
	15-year asset eligible for 50% bonus depreciation	15-year asset eligible for 100% bonus depreciation	39-year asset ineligible for bonus depreciation
0% Inflation	$89.06	$100.00	$55.06
2% Inflation	$84.38	$100.00	$42.12

The drafting error causes businesses to have a higher tax burden on QIP investments than under previous law, an outcome that could have significant consequences, potentially slowing investment, employment, and output for those affected.

Higher Tax Burden Under the New Law		
Taxes Paid on a $100 Investment		
	Prior Law	**Current Law**
	15-year asset eligible for 50% bonus depreciation, 35% corporate tax rate	39-year asset ineligible for bonus depreciation, 21% corporate tax rate
QIP Investment	$100.00	$100.00
Allowable Deduction	$84.38	$42.12
Disallowed Cost Recovery	$15.62	$57.88
Tax on Disallowed Cost Recovery	$5.47	$12.15

The present value of this type of investment falls from $100 under 100 percent bonus depreciation to as low as $37.24—meaning in some instances businesses are unable to recover even half of their initial investment costs. This treatment understates costs and overstates profits, which in turn leads to a greater tax burden that increases the cost of making those types of investments.

Present Value Cost of Straight-Line Depreciation		
Assumes a $100 Investment		
	15-year Asset	**39-year Asset**
Full Expensing	$100.00	$100.00
MACRS at 0% Inflation	$76.14	$55.06
MACRS at 2% Inflation	$67.26	$42.12
MACRS at 3% Inflation	$64.72	$37.24

The unintended consequences from the technical error in TCJA will only become worse the longer the error persists. Given that this is a tax issue, Congress must act to correct the technical error in TCJA allowing retail businesses to be treated the fairly under the tax code when making investments in QIP.

LEGISLATION: The Restoring Investments in Improvements Act (H.R. 1869, S. 803) fixing the tax treatment for QIP was introduced in the Senate on March 14 by Sens. Pat Toomey (R-PA) and Doug Jones (D-AL). On March 26, Reps. Jimmy Panetta (D-CA) and Jackie Walorski (R-IN) introduced identical legislation in the House.

NLBMDA POSITION: NLBMDA supports accelerated bonus depreciation and a 15-year accelerated recovery period for QIP investments in retail operations.

REQUEST: NLBMDA encourages lawmakers to cosponsor and approve legislation making technical corrections to TCJA so QIP investments are eligible for 100 percent bonus depreciation and a 15-year recovery period.

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