

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201203014**

Release Date: 1/20/2012

CC:ITA:B07:DHKIM
POSTS-138703-11

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 168.36-00

date: December 14, 2011

to: John F. Eiman
Senior Counsel and Collateral Subject Matter Expert
Deductible and Capital Expenditures Issue Practice Group

from: Branch Chief, Branch 7
Office of Associate Chief Counsel (Income Tax and Accounting)

subject: Request for guidance regarding whether property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property or qualified retail improvement property is eligible for bonus depreciation under section 168(k)

This Chief Counsel Advice responds to your request for technical assistance dated September 19, 2011. This advice may not be used or cited as precedent.

ISSUES

1. Is qualified restaurant property which also meets the definition of qualified leasehold improvement property eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) of the Internal Revenue Code for taxable years 2008 and 2009 (assuming all other requirements in section 168(k) are met)?
2. Is qualified retail improvement property which also meets the definition of qualified leasehold improvement property eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) for taxable years 2008 and 2009 (assuming all other requirements in section 168(k) are met)?
3. If property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property or qualified retail improvement property is eligible for the 50-percent additional first year depreciation deduction under section

168(k)(1) (assuming all other requirements in section 168(k) are met) for taxable years 2008 and 2009, what steps must the taxpayer take to claim this deduction?

CONCLUSIONS

1. Qualified restaurant property (as defined in section 168(e)(7) as in effect on the day before the date of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008) that is placed in service in 2008 is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all requirements in section 168(k) are met). Qualified restaurant property (as defined in section 168(e)(7)) that is placed in service after December 31, 2008, during the 2008 and 2009 taxable years and that also meets the definition of qualified leasehold improvement property (as defined in section 168(e)(6), section 168(k)(3), and section 1.168(k)-1(c) of the Income Tax Regulations) is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met).
2. Qualified retail improvement property (as defined in section 168(e)(8)) that is placed in service after December 31, 2008, during the 2008 and 2009 taxable years and that also meets the definition of qualified leasehold improvement property (as defined in sections 168(e)(6), 168(k)(3), and 1.168(k)-1(c)) is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met). Although the 15-year property classification for qualified retail improvement property did not apply for depreciable property placed in service before 2009, any depreciable property that is placed in service in 2008 and that meets the definition of qualified leasehold improvement property (as defined in sections 168(e)(6), 168(k)(3), and 1.168(k)-1(c)) is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met).
3. If property that satisfies the definition of both qualified leasehold improvement property (as defined in sections 168(e)(6), 168(k)(3), and 1.168(k)-1(c)) and qualified restaurant property (as defined in section 168(e)(7)) or qualified retail improvement property (as defined in section 168(e)(8)) is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met), the taxpayer claims this deduction for this property as they would for any other item of qualified property (as defined in sections 168(k)(2) and 1.168(k)-1(b)). No special steps are necessary.

LAW AND ANALYSIS

Section 168(k)(1) (as amended by section 103 of the Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613 (February 13, 2008)) provides a 50-percent additional first year depreciation deduction for the taxable year in which qualified

property is placed in service by a taxpayer. The term “qualified property” is defined in sections 168(k)(2) and 1.168(k)-1(b).

Section 168(k)(2)(A)(i) defines the term “qualified property” as meaning, among other things, property (I) to which section 168 applies with a recovery period of 20 years or less, (II) which is computer software (as defined in section 167(f)(1)(B) for which a deduction is allowable under section 167(a) without regard to this subsection, (III) which is water utility property, or (IV) which is qualified leasehold improvement property. For purposes of section 168(k)(2)(A)(i)(I), section 1.168(k)-1(b)(2)(i)(A) provides that the recovery period is determined in accordance with section 168(c) regardless of any election made by the taxpayer under section 168(g)(7).

Section 168(k)(3) provides that the term “qualified leasehold improvement property” means any improvement to an interior portion of a building which is nonresidential real property if: (i) such improvement is made under or pursuant to a lease (as defined in section 168(h)(7)) by the lessee (or sublessee), or by the lessor, of that portion; (ii) that portion is to be occupied exclusively by the lessee (or any sublessee) of the portion; and (iii) the improvement is 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.

Section 1.168(k)-1(c) provides the rules relating to section 168(k)(3). For purposes of section 168(k), section 1.168(k)-1(c)(1) provides that qualified leasehold improvement property means any improvement, which is section 1250 property, to an interior portion of a building that is nonresidential real property if: (i) the improvement is made under or pursuant to a lease (as defined in section 1.168(k)-1(c)(3)(vi)) by the lessee (or any sublessee) of the interior portion, or by the lessor of that interior portion; (ii) the interior portion of the building is to be occupied exclusively by the lessee (or any sublessee) of that interior portion; and (iii) the improvement is placed in service more than 3 years after the date the building was first placed in service by any person. Section 1.168(k)-1(c)(2) provides that 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. For purposes of section 1.168(k)-1(c), section 1.168(k)-1(c)(3) defines the following terms: building, common area, elevator, escalator, enlargement, internal structural component, lease, nonresidential real property, and structural component.

Section 211(a) and (b) of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (October 22, 2004) (the “2004 Act”), amended section 168(e) by (i) classifying any qualified leasehold improvement property as 15-year property under section 168(e)(3)(E)(iv), and (ii) defining the term “qualified leasehold improvement

property” in section 168(e)(6). These provisions are effective for property placed in service after October 22, 2004.

Section 168(e)(6) provides that the term “qualified leasehold improvement property” has the meaning given such term in section 168(k)(3), except that (A) in the case of an improvement made by the person who was the lessor of such improvement when such improvement was placed in service, such improvement shall be qualified leasehold improvement property (if at all) only so long as such improvement is held by such person. Section 168(e)(6)(B) provides an exception to the rule under section 168(e)(6)(A) in the case of death and the transactions listed in section 168(e)(6)(B)(ii)-(v).

Section 211(a) and (c) of the 2004 Act also amended section 168(e) by (i) classifying any qualified restaurant property as 15-year property under section 168(e)(3)(E)(v), and (ii) defining the term “qualified restaurant property” in section 168(e)(7). These provisions are effective for property placed in service after October 22, 2004.

Section 168(e)(7) (as in effect on the day before the date of the enactment of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Pub. L. No. 110-343, 122 Stat. 3867 (October 3, 2008) (the “2008 Act”)) provided that the term “qualified restaurant property” means any section 1250 property which is an improvement to a building if (A) such improvement is placed in service more than 3 years after the date such building was first placed in service, and (B) more than 50 percent of the building’s square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals. This provision is effective for property placed in service after October 22, 2004, and before January 1, 2009.

Section 305(b) of the 2008 Act amended section 168(e)(7). As amended by section 305(b)(1) of the 2008 Act, section 168(e)(7)(A) provides that the term “qualified restaurant property” means any section 1250 property which is a building, or an improvement to an building, if more than 50 percent of the building’s square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals. Also, section 168(e)(7)(B) provides that qualified restaurant property is not considered qualified property for purposes of section 168(k). Section 168(e)(7) (as amended by section 305(b) of the 2008 Act) is effective for property placed in service after December 31, 2008.

Section 305(c) of the 2008 Act also amended section 168(e) by (i) classifying any qualified retail improvement property as 15-year property under section 168(e)(3)(E)(ix), and (ii) defining the term “qualified retail improvement property” in section 168(e)(8). These provisions are effective for property placed in service after December 31, 2008.

Section 168(e)(8)(A) provides that the term “qualified retail improvement property” means any improvement to an interior portion of a building which is nonresidential real property if (i) such portion is open to the general public and is used in the retail trade or

business of selling tangible personal property to the general public, and (ii) such improvement is placed in service more than 3 years after the date the building was first placed in service. In the case of an improvement made by the owner of such improvement, section 168(e)(8)(B) provides that such improvement shall be qualified retail improvement property (if at all) only so long as such improvement is held by such owner. Rules similar to the rules under section 168(e)(6)(B) apply for purposes of the preceding sentence. Section 168(e)(8)(C) provides that 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 benefitting a common area, or the internal structural framework of the building. Section 168(e)(8)(D) provides that qualified retail improvement property is not considered qualified property for purposes of section 168(k). This provision is effective for property placed in service after December 31, 2008.

Section 168(e)(3)(E) (as amended by section 737 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (December 17, 2010) (the "2010 Act")) provides, in part, a 15-year property classification for qualified leasehold improvement property and qualified restaurant property placed in service after October 22, 2004, and before January 1, 2012, and for qualified retail improvement property placed in service after December 31, 2008, and before January 1, 2012. Pursuant to section 168(c), 15-year property has a recovery period of 15 years.

The General Explanation of Tax Legislation Enacted in the 111th Congress prepared by the Joint Committee on Taxation Staff (JCS-2-11) (March 2011) (the "Bluebook") discusses section 737 of the 2010 Act on pages 610-612. Under "Present Law," the Bluebook states that qualified restaurant property and qualified retail improvement property are not eligible for the additional first year depreciation deduction under section 168(k). However, footnotes 1716 and 1718 in the Bluebook state that property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property or qualified retail improvement property is eligible for bonus depreciation.

Section 3.03(3) of Rev. Proc. 2011-26, 2011-16 I.R.B. 664, provides that qualified property that meets the definition of both qualified leasehold improvement property (as defined in sections 168(e)(6), 168(k)(3), and 1.168(k)-1(c)) and qualified restaurant property (as defined in section 168(e)(7)) or qualified retail improvement property (as defined in section 168(e)(8)) is eligible for the 50-percent or 100-percent additional first year depreciation deduction (assuming all other requirements in section 168(k) are met).

Issues 1 and 2

To qualify for the 50-percent additional first year depreciation deduction provided in section 168(k)(1), depreciable property must be qualified property as defined in section

168(k)(2) and section 1.168(k)-1(b). Pursuant to section 168(k)(2)(A), depreciable property must meet several requirements to be qualified property. One of these requirements is provided under section 168(k)(2)(A)(i). This provision provides that depreciable property is qualified property if, among other things, the depreciable property is property to which section 168 applies with a recovery period of 20 years or less, or is qualified leasehold improvement property.

Qualified leasehold improvement property (as defined in sections 168(e)(6), 168(k)(3), and 1.168(k)-1(c)) meets the requirement in section 168(k)(2)(A)(i)(IV). Accordingly, any depreciable property that meets the definition of qualified leasehold improvement property is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met).

Section 168(e)(7) (as amended by section 305(b)(1) of the 2008 Act) provides that qualified restaurant property placed in service after December 31, 2008, is not eligible for the additional first year depreciation under section 168(k). Section 168(e)(8) provides that qualified retail improvement property placed in service after December 31, 2008, is not eligible for the additional first year depreciation deduction under section 168(k).

However, in some cases, qualified restaurant property placed in service after December 31, 2008, also meets the definition of qualified leasehold improvement property. In such a case, both the Bluebook and section 3.03(3) of Rev. Proc. 2011-26 provide that the property is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met). For example, if in 2009 a taxpayer constructs and places in service an improvement to an interior portion of a restaurant building and that improvement meets the definition of both qualified restaurant property and qualified leasehold improvement property, the improvement is eligible for the 50-percent additional first year depreciation deduction (assuming all other requirements in section 168(k) are met). However, if in 2009 a taxpayer constructs and places in services a new restaurant building, that building is not qualified leasehold improvement property and is not eligible for the additional first year depreciation deduction under section 168(k).

Similarly, in some cases, qualified retail improvement property placed in service after December 31, 2008, also meets the definition of qualified leasehold improvement property. In such a case, both the Bluebook and section 3.03(3) of Rev. Proc. 2011-26 provide that the property is eligible for the 50-percent additional first year depreciation deduction under section 168(k) (assuming all other requirements in section 168(k) are met).

Accordingly, qualified restaurant property (as defined in section 168(e)(7) as amended by section 305(b)(1) of the 2008 Act) that is placed in service after December 31, 2008, and that also meets the definition of qualified leasehold improvement property is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1)

(assuming all other requirements in section 168(k) are met). If qualified restaurant property placed in service after December 31, 2008, does not meet the definition of qualified leasehold improvement property, such qualified restaurant property is not eligible for the additional first year depreciation deduction under section 168(k) even though this property has a recovery period of 15 years.

Further, qualified retail improvement property (as defined in section 168(e)(8)) that is placed in service after December 31, 2008, and that also meets the definition of qualified leasehold improvement property is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met). If qualified retail improvement property placed in service after December 31, 2008, does not meet the definition of qualified leasehold improvement property, such qualified retail improvement property is not eligible for the additional first year depreciation deduction under section 168(k) even though this property has a recovery period of 15 years.

Prior to the 2008 Act, qualified restaurant property (as defined in section 168(e)(7) as in effect on the day before the date of the enactment of the 2008 Act) placed in service after October 22, 2004, and before January 1, 2009, is classified as 15-year property under section 168(e)(3)(E)(v). Consequently, this property has a recovery period of 15 years under section 168(c) and meets the requirement in section 168(k)(2)(A)(i)(I). Further, section 168(e)(7) as in effect on the day before the date of the enactment of the 2008 Act did not provide that qualified restaurant property is not eligible for the additional first year depreciation deduction under section 168(k). Accordingly, qualified restaurant property (as defined in section 168(e)(7) as in effect on the day before the date of the enactment of the 2008 Act) placed in service in 2008 is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met).

Further, prior to the 2008 Act, qualified retail improvement property placed in service before 2009 was classified as nonresidential real property under section 168(e)(2) with a recovery period of 39 years under section 168(c) or, if the property met the definition of qualified leasehold improvement property, was classified as 15-year property under section 168(e)(3)(E)(iv) with a recovery period of 15 years under section 168(c). Accordingly, any depreciable property that is placed in service in 2008 and that meets the definition of qualified leasehold improvement property is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met). Nonresidential real property, however, is not eligible for the additional first year depreciation deduction under section 168(k).

Issue 3

If property that satisfies the definition of both qualified leasehold improvement property (as defined in sections 168(e)(6), 168(k)(3), and 1.168(k)-1(c)) and qualified restaurant property (as defined in section 168(e)(7)) or qualified retail improvement property (as

defined in section 168(e)(8)) is eligible for the 50-percent additional first year depreciation deduction under section 168(k)(1) (assuming all other requirements in section 168(k) are met), the taxpayer claims this deduction for this property as they would for any other item of qualified property (as defined in sections 168(k)(2) and 1.168(k)-1(b)). No special steps are necessary.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4930 if you have any further questions.