Statement for the Record

Of

The Depreciation Fairness Coalition

For The Hearing On

"How Business Tax Reform Can Encourage Job Creation"

Before

The U.S. House of Representatives
Committee on Ways and Means

Thursday, June 2, 2011

Chairman Camp, Ranking Member Levin, and members of the House Committee on Ways and Means, thank you for the opportunity to submit this statement for the record on behalf of the Depreciation Fairness Coalition. We applaud the Chairman and the Committee's leadership on tax reform.

Currently, the tax law presents taxpayers with a great deal of complexity and uncertainty, impacting responses to tax incentives. Tax reform provides an opportunity to address these issues. Done properly, a comprehensive and nuanced review of the tax system could result in predictability, simplicity, and fairness, while encouraging economic growth and job creation.

The Depreciation Fairness Coalition is comprised of the following industries: retail, restaurants, construction, franchisees/franchisors, real estate, and small business in general. In this regard, we specifically urge Congress to make permanent the temporary 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements. Bipartisan legislation to this effect (H.R. 1265) has been introduced by Committee Members Gerlach and Neal. A Senate companion bill (S. 687) has been introduced by Finance Committee members Conrad and Cornyn.

15-year Depreciation Schedule for Leasehold Improvements, Restaurant Improvements and New Construction, Retail Improvements

The Internal Revenue Code ("Code) contains a temporary provision under which leasehold improvements, restaurant improvements, new restaurant construction, and retail improvements can be depreciated over 15 years rather than a 39-year recovery period that would otherwise apply to nonresidential real property. By way of background, Congress permanently provided for the 15-year depreciation schedule for retail motor fuels outlet stores in the Small Business Job Protection Act of 1996. In recognition of their shorter expected lives, Congress subsequently expanded property subject to the 15-year depreciation schedule to include leasehold improvements (American Jobs Creation Act of 2004), restaurant improvements (American Jobs Creation Act of 2004) and new construction (Emergency Economic Stabilization Act of 2008), and retail improvements (Emergency Economic Stabilization Act of 2008).

The 15-year depreciation schedule for leasehold improvements, restaurant improvements, new restaurant construction, and retail improvements reflects the tax policy principle that costs of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time. With more than 130 million Americans patronizing restaurants and retail establishments each day, such building structures experience a daily human assault. These businesses must constantly make changes to keep up with the structural and cosmetic wear and tear caused by customers and employees. The heavy use accelerates deterioration of a building's entrance, lobbies, flooring, restrooms, and interior walls. For restaurants, National Restaurant Association research shows that most restaurants remodel and update their building structures every six to eight years. As a result, 15 years is a much more accurate timeframe for writing off restaurant buildings and improvements than is 39 years.

Moreover, a 15-year recovery period reduces the cost of capital expenditures and increases cash flow. In turn, this provides needed capital for American businesses – which, in turn, translates into American jobs. As demonstrated in Figure 1 below, the annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15-year, rather than a 39-year, depreciation schedule are considerable. For example, a restaurateur's annual tax liability would increase by nearly $10,000 if the recovery period for a $1 million investment were increased from 15 years to 39 years. In an industry with median profit margins of 3 to 5 percent, every penny counts. A more accurate recovery period frees resources to expand business either through new hires or further capital expenditures. Both contribute directly and indirectly to job creation as benefits are multiplied through the economy.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-Year Schedules
$100,000	$2,532	$608	$6,667	$1,600	$992
$250,000	$6,329	$1,519	$16,667	$4,000	$2,481
$500,000	$12,658	$3,038	$33,333	$8,000	$4,962
$700,000	$17,722	$4,253	$46,667	$11,200	$6,947
$1,000,000	$25,316	$6,076	$66,667	$16,000	$9,924
$1,500,000	$37,975	$9,114	$100,000	$24,000	$14,886
$2,000,000	$50,633	$12,152	$133,333	$32,000	$19,848

Expenditure Scenarios

Rebuild Costs:	Renovate Costs:
Quickservice - $700,000	Quickservice - $250,000
Fullservice - $1,500,000	Fullservice - $500,000

Note: Figures are based on a 24% effective marginal tax rate

However, the 15-year depreciation schedule for these properties is temporary and must be extended annually. The piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity. Moreover, in some cases, the provision has been allowed to lapse. This situation occurred recently, when the provision expired at the end of 2009. The provision was later retroactively extended for 2010 and prospectively extended for 2011 by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("2010 Act"), enacted in December 2010. The provision's lapse resulted in some businesses waiting to undertake capital improvements.

Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements would address this issue, providing taxpayers with predictability, simplicity, and fairness. Our nation's businesses are looking forward, planning capital expenditures to improve and expand their businesses. For example, according to the National Restaurant Association April 2011 Tracking Survey, 53 percent of restaurant operators plan to make a capital expenditure for equipment, expansion, or remodeling in the next six months---the highest level in 41 months. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making those decisions right now.

Moreover, the 15-year recovery period is an important driver of economic activity, fueling investment and job growth. When restaurants invest in construction and renovations, the impact spreads through the economy. Before the economic downturn, the restaurant industry spent more than $10 billion in 2007 on construction of restaurant buildings. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional $2.39 in spending in the rest of the economy and every $1 million spent in the construction industry creates more than 28 jobs in the overall economy. That means that restaurant industry construction spending created nearly 400,000 jobs in 2008 and 2009, at a time when the overall economy was contracting (see figure 2 below).

Figure 2.
Restaurant Spending on New Construction

Year	Billions ($)	Jobs Created In Overall Economy
2004	5.2	145,000
2005	7.4	208,000
2006	6.6	185,000
2007	10.4	292,000
2008	7.6	214,000
2009	6.2	174,000

Source: U.S. Census Bureau and National Restaurant Association

Conclusion

We greatly appreciate this opportunity to submit this testimony on behalf of the Depreciation Fairness Coalition today. Tax reform presents an opportunity to provide taxpayers with predictability and fairness, while encouraging economic growth and job creation. As Congress considers the important issue of tax reform, we are happy to be a resource for Congress and the Committee and urge you to make permanent the 15-year depreciation for leasehold improvements, restaurant improvements and new construction, and retail improvements.