PRESENT LAW AND LEGISLATIVE BACKGROUND RELATING TO DEPRECIATION AND SECTION 179 EXPENSING

Scheduled for a Public Hearing
Before the
SUBCOMMITTEE ON LONG-TERM GROWTH
AND DEBT REDUCTION
of the
SENATE COMMITTEE ON FINANCE
on July 21, 2005

Prepared by the Staff
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INTRODUCTION

The Subcommittee on Long-Term Growth and Debt Reduction of the Senate Committee on Finance has scheduled a public hearing on Thursday, July 21, 2005, on depreciation and section 179 expensing.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and legislative background relating to depreciation and section 179 expensing of tangible property used in a trade or business. This pamphlet does not address other cost-recovery concepts, such as amortization of intangible assets.

[1] This document may be cited as follows: Joint Committee on Taxation, "*Present Law and Legislative Background Relating to Depreciation and Section 179 Expensing*" (JCX-54-05), July 20, 2005.

I. PRESENT LAW AND BACKGROUND RELATING TO DEPRECIATION AND EXPENSING OF TANGIBLE PROPERTY USED IN A TRADE OR BUSINESS

A. Depreciation

In general

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property are generally assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from three to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.[2] In general, the recovery periods applicable to real property are 39 years for non-residential real property and 27.5 years for residential rental property. The depreciation method for real property is the straight-line method.

Under MACRS, the full basis of depreciable property is recovered by the taxpayer over the applicable recovery period; there is no need to estimate salvage value. Furthermore, under MACRS, the applicable recovery period need not (and typically does not) correspond to the actual economic life of the asset subject to depreciation. In general, however, MACRS generally provides for longer recovery periods for longer lived assets.

Legislative background

The current MACRS rules modified the "accelerated cost recovery system" ("ACRS") rules enacted in 1981.[3] In 1985, the staff of the Joint Committee on Taxation described the pre-1981 system:

> Class lives are generally based on guideline lives established for the Asset Depreciation Range ("ADR") system of depreciation that was adopted in 1971. Under the ADR system, a present class life was provided for all assets used in the same activities, other than certain assets with common characteristics (e.g., automobiles). Assets were grouped into more than 100 classes and a guideline life

[2] For certain property, including tangible property used predominantly outside the United States, tax-exempt use property, tax-exempt bond-financed property, and certain other property, the MACRS "alternative depreciation system" of section 168(g) applies, generally increasing recovery periods and requiring straight-line depreciation as described below.

[3] The "Economic Recovery Tax Act of 1981," Pub. L. No. 97-34, sec. 202 (1981).

> was determined by the former Office of Industrial Economics in the Treasury Department. The guideline lives established under the ADR system were about 30 to 40 percent shorter than the service lives found in Bulletin F, a publication concerning useful lives issued in 1942 by the Internal Revenue Service.[4]

In 1981, the prior-law ADR system was replaced by a new system, ACRS, which permitted "recovery of capital costs for most tangible depreciable property using accelerated methods of cost recovery over predetermined recovery periods generally unrelated to, but shorter than, [prior] law useful lives."[5] The Senate Finance Committee Report with respect to the provision explained the rationale for the change: "[t]he committee believes that the present rules for determining depreciation allowances . . . need to be replaced because they do not provide the investment stimulus that is essential for economic expansion. The real value of depreciation deductions allowed under present rules has declined for several years due to successively higher rates of inflation. . . . The committee therefore believes that a new capital cost recovery system is required which provides for the more rapid acceleration of cost recovery deductions . . . "[6]

These rules were tightened somewhat in 1982,[7] and modified more substantially in 1986,[8] when the MACRS rules were adopted. Primarily, MACRS further accelerated the rate of recovery of depreciation deductions from the 150-percent declining balance method to the 200-percent declining balance method for those tangible assets with the shortest class lives. In addition, certain assets were reclassified and the number of asset classes was increased.

Placed-in-service conventions

Depreciation of an asset begins when the asset is deemed to be placed in service under the applicable convention. Under MACRS, nonresidential real property, residential rental property and any railroad grading or tunnel bore are generally subject to the mid-month convention, which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month. All other property is generally subject to the half-year convention, which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) during the mid-point of such taxable year. However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention, designed to prevent the recognition of disproportionately large amounts of first-year depreciation under the half-year convention.

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[4] Joint Committee on Taxation, *"Tax Reform Proposals: Taxation of Capital Income"* (JCS-35-85), August 8, 1985, p 48.

[5] S. Rep 97-144, 48 (1981).

[6] *Id*. at 47.

[7] The "Tax Equity and Fiscal Responsibility Act of 1982," Pub. L. No. 97-248, sec. 206 (1982).

[8] The "Tax Reform Act of 1986," Pub. L. No. 99-514, sec. 201 (1986).

Recovery periods

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. In 1987, and again in 1988, the Treasury Department published "class lives" for various categories of depreciable property. The "class life" of an asset is then used to determine the "type of property" of the asset, which in turn dictates the applicable recovery period for the asset.

In addition, the MACRS provisions of the Internal Revenue Code explicitly categorize certain assets by type of property, effectively superseding any administrative guidance with regard to such property. Table 1, summarizes the various types of property and applicable recovery periods under MACRS:

Table 1.−Selected Property Classes and Recovery Periods under MACRS

Type of Property	General Rule-Class Life of:	Specific Classifications by Statute	Applicable Recovery Period
3-year property	4 years of less	Certain race horses and most other horses; qualified rent-to-own property.	3 years
5-year property	More than 4 but less than 10 years	Automobiles and light general purpose trucks; semi-conductor manufacturing equipment; computer-based telephone central office switching equipment; qualified technological equipment;[1] certain research property; certain solar, wind or geothermal energy property.	5 years
7-year property	10 or more but less than 16 years; also, property (other than real property) without a class life	Railroad track; certain motorsports entertainment complexes; certain Alaska natural gas pipeline.	7 years
10-year property	16 or more but less than 20 years	Any single purpose agricultural or horticultural structure; any tree or vine bearing fruit or nuts.	10 years
15-year property	20 or more but less than 25 years	Any municipal wastewater treatment plant; certain telephone distribution equipment; certain retail motor fuels outlet property; qualified leasehold improvements placed in service before January 1, 2006; qualified restaurant property placed in service before January 1, 2006; initial clearing and grading land improvements with respect to gas utility property.	15 years
20-year property	25 or more years	Initial clearing and grading land improvements with respect to any electric utility transmission and distribution plant	20 years
Water utility property			25 years
Residential rental property			27.5 years
Nonresidential real property			39 years
Any railroad grading or tunnel bore			50 years

[1] The term "qualified technological equipment" is defined as computers and related peripheral equipment, high technology telephone station equipment installed on a customer's premises, and high technology medical equipment. Sec. 168(i)(2).

Authority to set or modify class lives

When the MACRS system was enacted in 1986, the Congress directed the Secretary of the Treasury to establish an office to monitor and analyze actual experience with respect to depreciable assets and authorized the Secretary to prescribe or modify class lives for depreciable assets, provided that the new class life reasonably reflected the anticipated useful life and the anticipated decline in value over time of the property to the industry or other group.

Exercising the authority granted by the Congress, the Secretary issued Revenue Procedure 87-56,[9] laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Revenue Procedure 88-22.[10]

In November 1988, the Congress revoked the Secretary's authority to modify the class lives of depreciable property as part of the Technical and Miscellaneous Revenue Act of 1988.[11] Revenue Procedure 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets.[12]

Additional first-year depreciation deduction ("bonus depreciation")

For property generally placed in service prior to January 1, 2005, Congress provided an additional first-year depreciation deduction. The Job Creation and Worker Assistance Act of 2002[13] ("JCWAA") allowed an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified property for property placed in service on or after September 11, 2001, and before January 1, 2005. The Jobs and Growth Tax Relief Reconciliation Act of 2003[14] ("JGTRRA") provided an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property for property acquired and placed in service by the taxpayer after May 5, 2003 and before January 1, 2005.[15]

The legislative history for JGTRRA set forth the rationale for extending and increasing the benefit as follows:

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[9] 1987-2 CB 674.

[10] 1988-1 CB 785.

[11] Pub. L. No. 100-647, sec. 6253 (1988).

[12] See discussion below of recent statutory developments for specific types of property.

[13] Pub. L. No. 107-147, sec. 101 (2002).

[14] Pub. L. No. 108-27, sec. 201 (2003).

[15] The additional first-year depreciation deductions were subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A.

> The Committee believes that increasing and extending the additional first-year depreciation will accelerate purchases of equipment, promote capital investment, modernization, and growth, and will help to spur an economic recovery. As businesses accelerate their purchases of equipment current employment will increase to produce that equipment. Current business expansion also will increase employment opportunities in the years ahead.[16]

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property was placed in service.[17] The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

Section 168(k) provides detailed rules for determining whether property is eligible for the additional first-year depreciation, including time periods within which the property must have been acquired as well as placed in service (with exceptions for property acquired or constructed pursuant to a binding written contract entered into either before or during the relevant time periods), and other special rules for self-constructed and leased property.

Depreciation under the alternative minimum tax regime

In determining the amount of alternative minimum taxable income for any taxable year, taxpayers are generally required to calculate depreciation for certain assets under modified rules. Specifically, assets to which the 200-percent declining balance method is applicable under MACRS are depreciated using the 150-percent declining balance method for purposes of computing alternative minimum taxable income.[18]

In addition, for property placed in service on or before December 31, 1998, depreciation for alternative minimum tax purposes is calculated using the longer recovery periods of the alternative depreciation system as described below.[19]

Alternative depreciation system

When MACRS was enacted, Congress also created the alternative depreciation system ("ADS"), which is required to be used for property used predominantly outside the United States

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[16] H.R. Rep. No. 108-94, at 23.

[17] However, the additional first-year depreciation deduction was not allowed for purposes of computing earnings and profits.

[18] Sec. 56(a)(1)(A)(ii).

[19] Sec. 56(a)(1)(A)(i).

and certain tax-exempt use property.[20] Under ADS, all property is depreciated using the straight-line method, over recovery periods which are generally longer than those used under MACRS. Bonus depreciation is not available for property required to be depreciated using the alternative depreciation system.

Recovery period for tax-exempt use property subject to lease

Property that is leased to a tax-exempt person must be depreciated on a straight-line basis over a recovery period equal to the longer of the property's class life or 125 percent of the lease term.[21] Such property generally includes property that is leased (other than under a short-term lease) to a tax-exempt entity (including a foreign entity).[22] This provision serves to reduce the tax benefits available to lessors of property leased to or otherwise used by tax-exempt entities.

Special depreciation rules for liberty zone property

Section 1400L provides certain tax benefits for the area of New York City damaged in terrorist attacks on September 11, 2001 (an area defined in the provision and named the New York Liberty Zone). Among these benefits, section 1400L provides an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified New York Liberty Zone ("Liberty Zone") property.[23] For property which is already subject to the bonus depreciation rules, no further benefit is available under this provision. However, Liberty Zone property includes property placed in service on or before December 31, 2006 (December 31, 2009, in the case of nonresidential real property and residential rental property), thus allowing taxpayers the continued benefit of the additional 30 percent first-year depreciation deduction for Liberty Zone property, even after the expiration of the general bonus depreciation regime.[24]

In addition, section 1400L also provides that qualified New York Liberty Zone leasehold improvement property has an elective 5-year recovery period (rather than the 15-year recovery

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[20] Sec. 168(g).

[21] Sec. 168(g)(3)(A). In the case of computer software and intangible assets, this rule is applied by substituting useful life and amortization period, respectively, for class life.

[22] Sec. 168(h)(1). However, tax-exempt use property generally does not include qualified technological equipment that meets the exception for leases of high technology equipment to tax-exempt entities with lease terms of five years or less. Sec. 168(h)(3).

[23] Rules similar to the general bonus depreciation rules apply with regard to leased property, as well as with regard to self constructed property and property subject to a binding written contract in effect for the acquisition of the property at any time before September 11, 2001. Likewise, as with the general bonus depreciation regime, a taxpayer is allowed to elect out of the additional first-year depreciation on qualified Liberty Zone property for any class of property for any taxable year.

[24] Non-residential real property or residential rental property is Liberty Zone property only to the extent it rehabilitates real property damaged, or replaces real property destroyed or condemned, as a result of the September 11, 2001, terrorist attack. Sec. 1400L(b)(2)(B).

period for qualified leasehold improvement property placed in service before January 1, 2006, or the 39-year recovery period for qualified leasehold improvement property placed in service after December 31, 2005).

Special depreciation rules for luxury automobiles

Section 280F(a) limits the annual cost recovery deduction with respect to certain passenger automobiles otherwise depreciable under the general rules described above. This limitation is commonly referred to as the "luxury automobile depreciation limitation." For passenger automobiles placed in service in 2004, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $2,960 for the year in which the vehicle is placed in service, $4,800 for the second year, $2,850 for the third year, and $1,675 for the fourth and later years. This limitation applies to the aggregate deduction provided under present law for depreciation and section 179 expensing.

In general, the MACRS depreciation deductions for a vehicle placed in service in 2005 are less than the luxury automobile depreciation limitations if the vehicle costs less than $14,540. Thus, the limitations reduce the taxpayer's cost recovery deduction for such a vehicle only if the taxpayer is eligible for section 179 expensing of the cost of the vehicle. Whether a taxpayer purchasing a car for more than $14,540 is limited under present law depends upon the taxpayer's percentage of business use of the vehicle. In addition, the American Jobs Creation Act of 2004[25] ("AJCA") limits the deduction under section 179 for certain sport utility vehicles not subject to section 280F to $25,000.

[25] Pub. L. No. 108-357, sec. 201 (2004).

B. Recent Statutory Developments for Specific Types of Property

A number of changes were made in the 108th Congress to the statutory provisions governing recovery periods.

Recovery period for depreciation of certain leasehold improvements

AJCA provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2006. AJCA requires that qualified leasehold improvement property be recovered using the straight-line method. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[26] 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).[27] 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.

Recovery period for depreciation of certain restaurant improvements

AJCA provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2006.[28] For purposes of the provision, qualified restaurant property means any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and 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.[29] The Act requires that qualified restaurant property be recovered using the straight-line method.

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[26] Absent this provision, such improvements would generally have the same recovery period as the underlying nonresidential real property, i.e., 39 years, regardless of the term of the lease.

[27] 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.

[28] Qualified restaurant property becomes eligible for the additional first-year depreciation deduction under sec. 168(k) by virtue of the assigned 15-year recovery period.

[29] As with qualified leasehold improvement property, absent this provision, such improvements would generally have the same recovery period as the underlying nonresidential real property, i.e., 39 years.

Recovery period for permanent motorsports racetrack complexes

AJCA provides a statutory 7-year recovery period for permanent motorsports racetrack complexes. For this purpose, motorsports racetrack complexes include land improvements and support facilities, but do not include transportation equipment, warehouses, administrative buildings, hotels, or motels. The provision is effective for property placed in service after October 22, 2004, and before January 1, 2008.

Recovery period for Alaska natural gas pipeline

AJCA establishes a statutory seven year recovery period and a class life of 22 years for any Alaska natural gas pipeline. The term "Alaska natural gas pipeline" is defined as any natural gas pipeline system (including the pipe, trunk lines, related equipment, and appurtenances used to carry natural gas, but not any gas processing plant) located in the State of Alaska that has a capacity of more than 500 billion Btu of natural gas per day and is placed in service after December 31, 2013. A taxpayer who places an otherwise qualifying system in service before January 1, 2014 may elect to treat the system as placed in service on January 1, 2014, thus qualifying for the seven-year recovery period. Absent such an election, the system is subject to the prior law recovery period of 15 years.

C. Expensing for Small Businesses (section 179 of the Code)

In general

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2003 through 2007, is $100,000 of the cost of qualifying property placed in service for the taxable year.[30] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2008 is treated as qualifying property. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000. The $100,000 and $400,000 amounts are indexed for inflation.[31]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[32]

Legislative background

The rules of section 179 were originally enacted in 1958.[33] The 1958 legislation provided that a taxpayer could elect to deduct, as additional first-year depreciation, 20 percent of

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[30] Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400L(f)), an empowerment zone (sec. 1397A), or a renewal community (sec. 1400J).

[31] For taxable years beginning in 2008 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000.

[32] Sec. 179(c)(1). Under Treas. Reg. sec. 179-5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005. For taxable years beginning in 2008 and thereafter, an expensing election may be revoked only with consent of the Commissioner. Sec. 179(c)(2).

[33] "Small Business Tax Revision Act of 1958" [title II of H.R. 8381, the "Technical Amendments Act of 1958"], Pub. L. No. 85-866. sec. 204 (1958).

the cost of certain depreciable property. The cost of property eligible for this treatment was limited to $10,000, and consequently, the deduction was limited to $2,000 for the taxable year. Section 179 property was defined as depreciable property with a useful life of six years or more that was acquired by purchase after 1957 for use in a trade or business or for holding for the production of income.

In 1981, when the ACRS depreciation rules were adopted (generally providing accelerated methods and shorter recovery periods for depreciation), the section 179 rules were also revised to provide expensing of a greater amount.[34] The 1981 legislation provided that, for taxable years beginning in 1982 and 1983, a taxpayer could elect to deduct up to $5,000 of the cost of qualifying property placed in service in the taxable year. The dollar limitation was increased to $7,500 for taxable years beginning in 1984 and 1985, and increased to $10,000 for taxable years beginning in 1986 and thereafter.[35] Qualifying property was defined as property acquired by purchase for use in a trade or business (not including property held merely for the production of income). The provision was subsequently modified to provide that the dollar limitation on the deductible amount is reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during the taxable year exceeds a dollar threshold (currently $400,000).[36]

The dollar limitation was again increased in 1993 to $17,500 for taxable years beginning after 1992.[37] In 1996, the expensing provisions were again amended to provide for the dollar limitation to increase over a period of several years, ultimately reaching $25,000 for taxable years beginning in 2003 or thereafter.[38] In 2003, JGTRRA increased the relevant dollar amounts to their present-law limits, but only for tax years beginning after 2002 and before 2006 (sec. 202); AJCA extended these increased amounts through taxable years beginning before 2008 (sec. 201).

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[34] The "Economic Recovery Tax Act of 1981," Pub. L. No. 97-34, sec. 202 (1981).

[35] Subsequent legislation altered the years for which these amounts took effect. The $10,000 amount was to become effective for taxable years beginning in 1990 and thereafter, under section 13 of the "Tax Reform Act of 1984," Pub. L. No. 98-369 (1984), but was made effective for taxable years beginning after 1986, under section 202 of the "Tax Reform Act of 1986," Pub. L. No. 99-514 (1986).

[36] See section 202 of the "Tax Reform Act of 1986," Pub. L. No. 99-514 (1986).

[37] The "Omnibus Budget and Reconciliation Act of 1993," Pub. L. No. 103-66, sec. 13116(a) (1993).

[38] The "Small Business Job Protection Act of 1996," Pub. L. No. 104-188, sec. 1111(a) (1996).

II. ECONOMIC DATA

A. Taxonomy of Aggregate Investment in the United States

The Bureau of Economic Analysis ("BEA") of the Department of Commerce estimates annual investment in the United States as part of the BEA's measurement of gross domestic product. The amount of annual investment in the United States is large, averaging more than $1.5 trillion dollars annually during the period 1998 through 2002. Table 2 and Table 3 present the BEA's estimates of the capital investment by type of asset, by industry, and by organizational form. These data are compiled from various surveys that report on investment in equipment and structures by industry, by legal form. The data are further broken down into asset categories based on more detailed periodic surveys.

Table 2 breaks private fixed investment down into type of equipment or software, and type of structure. As shown, the largest category, other than structures, is computer software ($162 billion in 2002), followed by communication equipment ($89 billion in 2002), computers and computer peripheral equipment ($81 billion in 2002), and trucks, buses, and truck trailers ($61 billion in 2002). Table 3 reports that investment in the manufacturing industries comprised 15.6 percent ($165 billion out of $1,060 billion) of the total of private nonresidential fixed investment in 2002. Corporations (both C corporations and S corporations) account for the majority of nonresidential investment, $866 billion of the total $1,060 billion, or 82 percent.

Table 2.−Investment in Private Fixed Assets, Equipment and Software, and Structures by Type

[Billions of Dollars, Calendar Years]

Asset Type	1998	1999	2000	2001	2002
Private fixed investment	**1,441.9**	**1,560.8**	**1,680.9**	**1,643.6**	**1,564.0**
Equipment and Software					
1. Computers and peripheral equipment	86.9	95.7	101.2	85.2	81.2
2. Software	124.0	152.6	176.2	174.7	161.7
3. Communication equipment	87.4	99.3	124.1	110.1	88.6
4. Medical equipment and instruments	30.1	31.7	34.4	37.4	39.8
5. Nonmedical instruments	17.0	16.9	17.8	18.1	17.1
6. Photocopy and related equipment	12.5	10.4	9.6	6.7	7.0
7. Office and accounting equipment	5.2	4.0	4.1	4.7	5.0
8. Fabricated metal products	11.0	11.8	12.4	12.5	12.6
9. Engines and turbines	4.4	5.5	7.1	10.8	10.1
10. Metalworking machinery	30.1	29.3	30.0	25.6	23.3
11. Special industry machinery, not elsewhere classified	33.4	32.9	36.4	30.6	27.9
12. General industrial, including materials handling, equipment	47.3	45.7	48.6	44.4	42.4
13. Electrical transmission, distribution , and industrial apparatus	20.1	21.8	24.7	22.8	22.3
14. Trucks, buses, and truck trailers	79.4	89.5	81.8	65.1	60.8
15. Autos	35.0	37.8	36.8	31.0	28.0
16. Aircraft	20.8	30.3	32.6	35.2	24.3
17. Ships and boats	2.8	2.8	3.4	3.0	3.6
18. Railroad equipment	6.5	7.1	6.5	4.6	4.4
19. Furniture and fixtures	32.7	34.5	36.3	32.9	30.7
20. Agricultural machinery	16.9	12.4	13.7	14.6	16.5
21. Construction machinery	22.4	22.9	23.2	20.4	21.1
22. Mining and oil field machinery	3.6	5.4	5.3	6.2	4.8
23. Service industry machinery	16.5	17.5	17.5	17.6	16.7
24. Electrical equipment, not elsewhere classified	4.4	4.3	4.6	5.0	4.8
25. Other nonresidential equipment	31.1	32.2	33.9	34.4	35.2
26. Residential equipment	6.6	7.0	7.4	7.4	7.5
Total of Equipment and Software	**788.2**	**861.6**	**929.7**	**860.9**	**797.2**
Nonresidential structures					
1. Commercial, office and health care	115.2	124.0	137.2	137.4	116.0
2. Manufacturing	40.3	32.5	31.7	29.2	16.1
3. Power and communication	34.3	40.2	47.0	49.7	49.2
4. Petroleum and natural gas	22.3	19.5	25.8	37.8	28.0
5. Mining	1.1	1.0	1.3	1.3	1.2
6. Farm	4.3	5.1	6.0	5.1	5.8
7. Other	57.0	59.1	62.7	60.3	53.9
Total of Nonresidential Structures	**274.5**	**281.4**	**311.7**	**320.8**	**270.2**
Residential structures	**379.3**	**417.8**	**439.5**	**461.9**	**496.6**

Source: Bureau of Economic Analysis

Table 3.−Investment in Private Nonresidential Fixed Assets by Industry Group and Legal Form of Organization

[Billions of Dollars, Calendar Years]

Asset Type	1998	1999	2000	2001	2002
I. Private Nonresidential Fixed Investment					
A. Equipment and Software	**781.6**	**854.6**	**922.3**	**853.5**	**789.7**
B. Structures	**274.5**	**281.4**	**311.7**	**320.8**	**270.2**
Total of Private Nonresidential Fixed Investment	**1,056.1**	**1,136.0**	**1,234.0**	**1,174.4**	**1,059.9**
II. Industry Group					
A. Farms					
1. Equipment and software	23.8	19.4	20.8	21.9	23.4
2. Structures	2.6	3.1	4.1	4.7	3.8
Total of Farms	**26.4**	**22.5**	**24.9**	**26.6**	**27.2**
B. Manufacturing					
1. Equipment and software	171.8	165.3	169.8	157.5	146.5
2. Structures	26.5	26.5	28.3	29.2	18.4
Total of Manufacturing	**198.3**	**191.8**	**198.1**	**186.7**	**164.9**
C. Nonfarm, Nonmanufacturing					
1. Equipment and software	586.0	670.0	731.7	674.1	619.8
2. Structures	245.3	251.7	279.3	286.9	248.0
Total of Nonfarm, Nonmanufacturing	**831.4**	**921.7**	**1,011.1**	**961.0**	**867.8**
III. Legal Form of Organization					
A. Corporate					
1. Equipment and software	664.4	732.6	793.2	727.0	665.9
2. Structures	205.7	211.2	237.0	245.6	200.4
Total of Corporate	**870.2**	**943.9**	**1,030.2**	**972.6**	**866.3**
B. Noncorporate					
1. Sole Propietorship					
a. Equipment and software	48.8	48.7	50.4	48.5	47.9
b. Structures	12.6	13.7	14.9	14.4	12.0
Total of Sole Propietorship	**61.4**	**62.4**	**65.3**	**62.9**	**59.9**
2. Partnership					
a. Equipment and software	32.2	35.1	36.7	35.1	33.5
b. Structures	18.6	19.4	20.4	18.9	16.1
Total of Partnership	50.8	54.5	57.1	54.0	49.6
3. Nonprofit institutions					
a. Equipment and software	34.2	35.9	39.3	40.4	40.2
b. Structures	35.7	35.1	37.3	40.2	40.1
Nonprofit institutions	69.9	70.9	76.7	80.6	80.4
4. Households					
a. Equipment and software	0.6	0.7	0.5	0.5	0.5
b. Structures	1.3	1.3	1.3	1.0	0.8
Total of Households	1.9	2.0	1.8	1.5	1.4
5. Tax-exempt cooperatives					
a. Equipment and software	1.4	1.6	2.1	1.9	1.7
b. Structures	0.5	0.6	0.8	0.8	0.7
Total of Tax-exempt cooperatives	1.9	2.3	3.0	2.7	2.4
Subtotal of Equipment and software	117.2	121.9	129.2	126.5	123.8
Subtotal of Structures	68.7	70.1	74.7	75.3	69.8
Total of Noncorporate	**185.9**	**192.1**	**203.9**	**201.7**	**193.7**

Source: Bureau of Economic Analysis

B. Investment Subject to Tax Expensing or Depreciation

Investment as estimated by the BEA and reported in Table 2 and Table 3, above, does not correspond to investment subject to expensing under section 179 or depreciation under MACRS. There are several reasons for the difference between what constitutes depreciable investment by taxpayers and what the BEA estimates as investment for the purpose of measuring the nation's gross domestic product. First, from the taxpayer's perspective, an expenditure is chargeable to the taxpayer's capital account regardless of whether the item purchased is new or used. Thus, investment for tax purposes encompasses purchases of both new and used equipment and structures. For purposes of measuring gross domestic product, only acquisitions of new equipment and structures are generally relevant.[39] Also, for purposes of measuring gross domestic product, the BEA estimates investments by tax-exempt persons (see for example "nonprofit institutions" in Table 3) and investments in owner-occupied housing. Generally, the cost of such investments is not recoverable under federal income tax law. Some expenditures that the BEA labels as "investment" are not recoverable by taxpayers under section 179 expensing or MACRS. For example, software sold separately generally is amortized as an intangible rather than depreciated, although certain software is eligible for section 179 expensing for taxable years beginning in 2002 through 2007.[40]

Table 4, shows the distribution of investment as it appears on tax depreciation schedules for the period 1998 through 2002.[41] Throughout this period, investment in equipment in the 5-year MACRS class is the largest component of investment, followed by investment in non-residential structures, and investment in equipment in 7-year MACRS class. The allowance for bonus depreciation ("special depreciation allowance" in the table) makes direct comparison of aggregate investment by MACRS class problematic for 2001 and 2002.

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[39] BEA does adjust its estimate of investment for the net purchase or sale of used property between the business sector and any other sector of the economy.

[40] Software included with a computer is recovered as a part of the computer and BEA uses this same method.

[41] These data omit listed and alternative depreciation system property. The data were compiled by combining reported investment across all business forms and adjusting for potential double counting. For example, section 179 expensing would be double-counted on pass-through returns and S corporation returns and on the returns of the underlying partners or shareholders. Thus, only the section 179 deduction on individual Form 1040 and C corporation returns is included in measuring section 179 expensing).

Table 4.−Investment by Depreciation Method, Tax Return Data[1]

[Billions of Dollars, Tax Years]

Depreciation Class	1998	1999	2000	2001	2002
Equipment					
1. S179	25.0	27.9	27.5	28.3	27.7
2. Special depreciation allowance	---	---	---	20.0	116.0
3. MACRS class					
3 years	29.3	33.2	31.0	26.1	28.9
5 years	344.9	366.4	380.9	352.7	270.0
7 years	209.7	231.5	226.0	216.0	186.5
10 years	18.4	17.7	22.7	19.0	15.6
15 years	46.3	53.4	64.6	66.9	58.9
20 years	27.0	37.0	39.8	44.3	37.6
25 years	1.4	2.0	2.5	2.9	3.4
Total of Equipment	**702.1**	**769.1**	**795.0**	**776.2**	**744.6**
Structures					
1. Non-residential	230.8	241.7	242.4	255.8	234.7
2. Residential	125.2	137.6	150.7	150.2	181.4
Total of Structures	**356.0**	**379.3**	**393.1**	**406.0**	**416.1**
NET TOTAL	**1,058.1**	**1,148.4**	**1,188.1**	**1,182.2**	**1,160.7**

Source: Compiled from Depreciation and Amortization Form 4562 as included with original tax returns (sole proprietor, farm, rental, partnership and corporate returns) as edited by the Statistics of Income Division of the Internal Rervenue Service.

[1] Table excludes listed property, amortized property, and property recovered under the alternative depreciation system.

In addition to the differences previously noted between investment for the purpose of measuring gross domestic product and for the purpose of cost recovery under federal income tax law, the annual aggregates reported in Table 4 and Table 2 and Table 3, above, are not comparable because Table 4 reports investment on a tax year basis, rather than a calendar year basis. Another facet of the data creating non-comparability arises because, for federal income tax purposes, investment generally is reported when the property acquired is placed in service. In the BEA estimates, expenditures across years related to a single investment (*e.g.*, construction of an office building) are reported in the year in which the expenditure takes place.