

Reconstruction Watch

**Promoting Fair and Effective Use of New York City's
Economic Development Resources
After September 11th**

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What Is Accelerated Depreciation and What Does It
Mean for Lower Manhattan and NYC?

A project of Good Jobs New York

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What is Reconstruction Watch?

Reconstruction Watch is intended to assist low and moderate income New Yorkers in understanding and influencing the reconstruction process. Through its research and publications, Reconstruction Watch will provide these New Yorkers and the organizations that assist and represent them with timely information that they can use to participate effectively in the reconstruction process.

Reconstruction Watch will:

- Provide useful information on the key players in the reconstruction process.
- Analyze, in plain English, the subsidy proposals being advanced at the federal, state and city levels to foster economic development in New York City in the wake of the September 11th attacks. Do the proposed subsidies have quality job standards? Are there safeguards for taxpayers for companies who don't keep their agreements? What are the benefits and drawbacks of each proposed subsidy?
- Report on subsidies targeted to specific firms including the estimated dollar value of the deal, the company's job creation and retention performance, its compliance with environmental and labor standards, and previous subsidies received.

Feedback from members of the public is crucial to this project. Please contact us with questions or suggestions.

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For additional information visit www.reconstructionwatch.net

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Executive Summary

This Reconstruction Watch report analyzes the Accelerated Depreciation Allowance section of the Job Creation & Worker Assistance Act of 2002. One provision of the Accelerated Depreciation Allowance provides for a program of bonus depreciation for investments throughout the country, including Lower Manhattan. In addition, Congress included a few special extensions of the depreciation bonus specific to the Liberty Zone in Lower Manhattan in response to the events of September 11, 2001. The intent is to encourage companies to make investments in equipment and property in order to stimulate the economy and promote the renewal of the Liberty Zone over the next eight years.

The national program allows companies to deduct 30% of the value (purchasing price) of their assets during the first year after purchasing them, rather than over the “useful life” of the asset. This gives companies one large amount of money through tax savings up front that they would have otherwise received in small increments over a long period of time. The program specific to companies in the Liberty Zone expands this benefit in two important ways. First, it offers a five year or, in the case of new construction, eight year, rather than a three year window during which companies can take advantage of the tax write-off. Second, it includes commercial real estate and residential rental property, rather than just the “leaseholder improvements” available nation-wide.

It is important to point out that while the Accelerated Depreciation Allowance has not received much attention outside budget analysis circles, this program will cost \$3 billion in lost revenue to the US treasury in its first five years. According to the New York City Independent Budget Office (IBO), this provision of the Act is likely to result in the largest amount of lost revenues during this time period, compared to the others in the law¹. In New York City, for example, the NYC IBO estimates that costs from the Liberty Zone Accelerated Depreciation Allowance will be \$96 million in 2003 and \$72 million in 2004.

For additional information on other provisions of the Job Creation & Worker Assistance Act of 2002, visit www.reconstructionwatch.net.

This publication is the fourth in a four-part series whose aim is to better enable low- and moderate-income New Yorkers and small businesses to participate in the Reconstruction process. Previous Reconstruction Watch publications as well as other information about the rebuilding effort are available at www.reconstructionwatch.net, including: Publication #1 - The Lower Manhattan Development Corporation: Who Are These People and Where Did They Come From? Publication #2 - An Analysis of the “Draft Assistance Plan for Individuals.” How Will Lower Manhattan Residents Benefit? Publication #3 - An Analysis of the “Job Creation and Worker Assistance Act of 2002” Private Activity Bonds. An Opportunity for Public Input?

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¹ Information from the NYC IBO “is available at <http://www.ibo.nyc.ny.us/iboreports/stimlet.pdf> released March, 2002 and Fiscal Revenue Update: Dimmer for 2003 But a Little Brighter 2004-2006

Quick Primer on Depreciation

Since many readers may not be familiar with business tax law, we offer a brief Primer on capital assets and depreciation to better understand the subject and how the new law works.

For the purpose of the new law, "depreciation" is the allocation of the cost of an asset over a period of time for accounting and tax purposes. It is also the decline in the value of a property due to general wear and tear.

Most "ordinary and necessary" operating expenses (rent, paper goods, postage, etc.) can be "expensed" or deducted from taxes in the year they're purchased. Major assets that have a useful life beyond one year are known as "capital assets" (equipment, vehicles, furniture, etc.) and are subject to special treatment under the tax laws. Generally, the cost of "capital assets" must be written off (that is, depreciated or amortized) over more than one year.

Theoretically, the cost of an asset should be deducted over the number of years that the asset would be used, according to the actual drop in value that the asset will suffer each year. At the end of the asset's useful life for the business, any undepreciated portion would represent the salvage value for which the asset could be sold or scrapped.

Since the actual drop in value of each business asset would be difficult and time-consuming to compute, accountants use a variety of conventions to approximate and standardize the depreciation process.

For example, the straight-line method assumes that the asset depreciates by an equal percentage of its original value for each year that it's used. In contrast, the declining balance method assumes that the asset depreciates more in the earlier years. The following table compares the depreciation amounts that would be available under these two methods, for a \$1,000 asset that's expected to be used for five years and then sold for \$100 in scrap.

Year	Straight-line Method		Declining-value Method	
	Annual Depreciation	Year-end Book Value	Annual Depreciation	Year-end Book Value
1	$\$900 \times 20\% =$ \$180	$\$1,000 - \$180 =$ \$820	$\$1,000 \times 40\% =$ \$400	$\$1,000 - \$400 =$ \$600
2	$\$900 \times 20\% =$ \$180	$\$820 - \$180 =$ \$640	$\$600 \times 40\% =$ \$240	$\$600 - \$240 =$ \$360
3	$\$900 \times 20\% =$ \$180	$\$640 - \$180 =$ \$460	$\$360 \times 40\% =$ \$144	$\$360 - \$144 =$ \$216
4	$\$900 \times 20\% =$ \$180	$\$460 - \$180 =$ \$280	$\$216 \times 40\% =$ \$86.40	$\$216 - \$86.40 =$ \$129.60
5	$\$900 \times 20\% =$ \$180	$\$280 - \$180 =$ \$100	$\$129.60 \times 40\% =$ \$51.84	$\$129.60 - \$51.84 =$ \$77.76

As is clear, the straight-line method results in the same deduction amount every year, while the declining-balance method results in larger deductions in the first years and much smaller deductions in the last two years. The IRS has established rules for the allowable annual percentage deduction based on the expected life of the item and the depreciation method chosen.

Accelerated Depreciation Allowance	
Description	This provision of the "Job Creation and Worker Assistance Act" provides businesses in the Liberty Zone with an accelerated first-year depreciation deduction equal to 30% of the cost of certain property purchased after September 11, 2001. The intent is to encourage companies to make investments in equipment and property in order to stimulate the economy and promote the renewal of the Liberty Zone. Companies in the Liberty Zone may take advantage of the special depreciation deduction for five years (eight years for new structures) from the enactment year of 2002. The Liberty Zone is located south of Canal St., south of East Broadway to the East of Canal, and south of Grand St. to the east of East Broadway.
How is the benefit calculated?	<p><u>Example</u>: A company buys machinery or other equipment for \$1 million. The company is allowed to deduct 30% of the cost (\$300,000) from its taxable income. In addition, the company may still deduct a portion of the remaining cost of \$700,000 ("adjusted basis") from their income using one of several methods for calculating depreciation.</p> <p>Existing law allows companies to depreciate the entire cost of these investments but the tax benefits accrue over the useful life of the goods, which can vary from 3 to over 40 years. The new provision gives businesses a huge tax break for the year in which the equipment is purchased. It essentially frontloads the tax savings available to companies through existing laws by giving companies more of the money they would save over the "useful life" of the equipment during the first year.</p>
Costs	<p>According to Congress' Joint Committee on Taxation, this special provision will cost the U.S. Treasury \$3 billion in lost corporate income tax revenues in the first five years.</p> <p>There is no estimate of what the Accelerated Depreciation Allowance will cost New York City and State, although the New York City Independent Budget Office (IBO) estimated that the city will lose \$297 million in 2002 and 2003 due to the entire stimulus package (all elements, not only accelerated depreciation). However, the IBO calls the accelerated depreciation provision "the most significant feature of the stimulus act." Therefore, it is likely to result in the largest amount of lost revenues.</p>
Comments	<p>The national stimulus act contains an accelerated depreciation provision that is nearly identical to the one crafted for Lower Manhattan. The only significant differences are the term (3 years nationally vs. 5 or 8 years in the Liberty Zone for equipment and machinery) and the coverage (restricted to "leasehold improvements" nationally but including "commercial real property or residential rental property" in the Liberty Zone). Therefore, with very limited exceptions, there is no advantage for a company to <i>locate in</i> or <i>return to</i> Lower Manhattan since the same tax breaks are available anywhere in the U.S.</p> <p>On the other hand, availability of the depreciation bonus for new construction provides an enormous tax benefit to the relatively few private property owners in the immediate vicinity of the World Trade Center. New building construction requires relatively high levels of investment in an asset with a relatively long useful life. Property owners putting up new buildings can therefore reap significant savings from writing off 30% of their investment during the first year.</p>

