

Revenue Ruling 68-607

Costs incurred for improvements made on a state-owned highway right-of-way to provide ingress and egress to a shopping center developed on leased land are capital expenditures amortizable over the term of the lease.

Advice has been requested whether certain expenditures made by a taxpayer for improvements on a state-owned highway right-of-way to provide ingress and egress to the taxpayer's shopping center are capital expenditures amortizable over the period of the taxpayer's lease, under the circumstances described below.

The taxpayer is in the business of developing a shopping center on a tract of land that it has leased for a period of 99 years and leasing space in the shopping center to tenant merchants. One of the major shopping center tenants, before signing a lease, required the taxpayer to provide entrances and exits to adjacent public streets and highways.

To meet these requirements, the taxpayer constructed certain physical improvements consisting of traffic signals, treadles for controlling the signals, a lane for left turns into the shopping center, and deceleration and acceleration lanes in front of the shopping center for right turns into and out of the center. These improvements were all made on the state-owned highway right-of-way.

After construction of the improvements, the taxpayer formally transferred ownership of them to the state. These improvements will be maintained and replaced, when necessary, by the state.

Section 263 of the Internal Revenue Code of 1954 provides that no deduction shall be allowed for amounts paid for permanent improvements or betterments made to increase the value of any property.

Section 1.162-11 (b) of the Income Tax Regulations provides that the cost of improvements made on property of which the taxpayer is the lessee is a capital investment and is not deductible as a business expense.

Under the facts in the instant case, a capital expenditure resulted from the investment made by the taxpayer. Although the taxpayer acquired no tangible property interest in the improvements to the state-owned highway right-of-way, its investment resulted in the acquisition of a long-term direct business advantage since it provided the taxpayer's shopping center with the necessary means of ingress and egress. See *Kauai Terminal, Ltd.*, 36 B.T.A. 893, at 897 (1937). Such a business advantage is an intangible asset. See Rev. Rul. 66-71, C.B. 1966-1,44.

Section 1.167 (a)-3 of the regulations provides that if an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible

asset may be the subject of a depreciation allowance. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No depreciation allowance will be permitted merely because in the unsupported opinion of the taxpayer an intangible asset has a limited useful life.

If the taxpayer had owned the land on which the shopping center is constructed, the useful life of the business advantage secured by virtue of the subject expenditures would not be limited since not only the maintenance of the improvements, but also their replacement, when necessary, will be provided by the state. Thus, the improvements would indefinitely benefit such land.

Under the facts in this case, however, the taxpayer did not own the land, but only possessed a leasehold interest therein. Thus, the period of economic usefulness to the taxpayer of the subject improvements is limited in duration to the lease term of 99 years.

Section 1.167 (a)-4 of the regulations deals with capital expenditures made by a lessee of property. In pertinent part, this provision indicates that if the estimated useful life of improvements made by a lessee to the leased property, determined without regard to the terms of the lease, would be longer than the remaining period of the lease, annual deductions from gross income will be permitted in an amount equal to the unrecovered cost of the capital expenditure divided by the number of years remaining of the term of the lease. Such deductions are in lieu of allowances for depreciation and are allowed under section 162 of the Code as provided in section 1.162-11 (b) of the regulations.

Accordingly, based on the facts in this case, the expenditures incurred by the taxpayer for the improvements to the state-owned highway right-of-way are capital expenditures that resulted in the acquisition by the taxpayer of an intangible asset in the form of a long-standing direct business benefit. Since the expenditures were incurred by the taxpayer in the first year of the lease term, the amount of the annual deduction allowable under the provisions of section 1.162-11 (b) of the regulations is equal to the total cost of the improvements divided by 99 years, the term of the lease. Such annual deduction is for amortization in lieu of depreciation.