Walgreen Co. & Subsidiaries v. Commissioner, 103 T. C. 582 (1994)

Section 1250 property must be explicitly included in ADR classes by the Treasury Department to be part of the ADR system for depreciation purposes.

Summary

Walgreen Co. claimed depreciation on leasehold improvements for its pharmacies and restaurants under the ADR system, classifying them in ADR class 57. 0. The Commissioner argued these improvements were not explicitly included in any ADR class and should be depreciated over 15 years as Section 1250 property. The court held that Section 1250 property was removed from the ADR system by the 1974 Act unless explicitly included by the Treasury, and since ADR class 57. 0 did not explicitly include such property, Walgreen's improvements were subject to 15-year depreciation.

Facts

During 1980-1984, Walgreen Co. made significant leasehold improvements to properties it leased for operating pharmacies and Wags restaurants. These improvements, totaling over $46 million, were classified by Walgreen as Section 1250 property and depreciated using a 7-year life for pre-1981 improvements under the ADR system and a 10-year life for post-1980 improvements under the ACRS, based on their inclusion in ADR class 57. 0. The Commissioner challenged this classification, asserting the improvements were not part of any ADR class and thus should be depreciated over 15 years.

Procedural History

Walgreen filed a petition with the U. S. Tax Court after receiving a notice of deficiency from the IRS for the tax years ending August 31, 1983, and August 31, 1984. The Tax Court heard the case and issued its decision on November 10, 1994.

Issue(s)

1. Whether ADR class 57. 0, Distributive Trades and Services, includes Section 1250 property?
2. If ADR class 57. 0 does include Section 1250 property, whether it differentiates between structural and nonstructural components of a building?

Holding

1. No, because Section 1250 property must be explicitly included in ADR classes by the Treasury Department, and ADR class 57. 0 did not explicitly include Section 1250 property.
2. This issue was not reached as the court found that ADR class 57. 0 did not include any Section 1250 property.

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Court’s Reasoning

The court analyzed the legislative history and regulatory framework of the ADR system and the ACRS, focusing on the 1974 Act which removed Section 1250 property from the ADR system unless explicitly prescribed by the Treasury. The court reviewed various Revenue Procedures and found that ADR class 57. 0 did not explicitly include any Section 1250 property. The court emphasized the clear statutory language of the 1974 Act and the absence of any evidence that Congress intended for Section 1250 property to be included in the ADR system unless explicitly excluded. The court concluded that since the Treasury did not explicitly include Walgreen’s leasehold improvements in ADR class 57. 0, they were not part of the ADR system and thus subject to 15-year depreciation as Section 1250 property.

Practical Implications

This decision clarifies that Section 1250 property must be explicitly included in ADR classes to be part of the ADR system, affecting how taxpayers classify and depreciate real property improvements. It underscores the importance of Treasury regulations in defining depreciation classes and may lead to increased scrutiny of property classifications for tax purposes. The ruling also has implications for future legislative and regulatory changes regarding depreciation, potentially influencing how businesses plan for and report depreciation on real property improvements. Subsequent cases have referenced this decision in addressing similar issues of property classification and depreciation.

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