

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:ITA:5 – PLR-119036-00
Date: July 2, 2002

▷

In Re:

LEGEND:

Parent =
Subsidiary 1 =
Subsidiary 2 =
Taxpayer =
Dealers =

Equipment A =
Equipment B =
Division 1 =
Division 2 =
QI =

Escrow Holder =

Bank =
Account =

Date A =
x Days =
Agreement A =

Settlement =
Subaccounts A, B, C, and D =

Account X =

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Company =

Dear :

This letter responds to your request for a private letter ruling submitted on behalf of Parent, requesting certain rulings under section 1031 of the Internal Revenue Code, including a ruling that the transfers of equipment described below are deferred exchanges qualifying for nonrecognition of gain or loss under that provision.

FACTS

Taxpayer is a wholly owned subsidiary of Subsidiary 1. Subsidiary 1 is a wholly owned subsidiary of Subsidiary 2. Subsidiary 2 is a wholly owned subsidiary of Parent, a manufacturer of certain equipment. For federal income tax purposes, Parent, Subsidiary 1, Subsidiary 2 and Taxpayer are included in the consolidated income tax returns of Parent. Taxpayer's overall accounting method is accrual. For maintaining its accounting books and filing its federal income tax return, Taxpayer uses an annual accounting period that ends on October 31. Taxpayer is engaged in the business of leasing equipment to customers of various independent dealers who sell equipment manufactured by Parent, and in limited circumstances, leasing equipment directly to dealers. Of Taxpayer's various leasing divisions, Division 1 and Division 2 are the subjects of the below ruling requests.

QI uses the accrual method of accounting and maintains its accounting records and files its federal income tax returns on a calendar year. Neither the Taxpayer nor Parent has any equity or ownership interest in QI or any affiliate of QI. Prior to the below transactions, there has been no previous financial or other relationship between the QI and Taxpayer or Parent.

Escrow Holder is a subsidiary of Bank and uses the accrual method of accounting. Escrow Holder maintains its accounting books and files its federal income tax returns on a calendar year. You represent that any interest held by Parent in Escrow Holder or Bank represents less than a 10 percent interest in any class of Bank's outstanding securities. Bank has maintained bank accounts, acted as a lock box and acted as an administrative agent in commercial paper issuance for Taxpayer in the past. A Bank subsidiary separate from Escrow Holder has acted as a co-underwriter in the issuance of bonds by Parent, but is not Parent nor Taxpayer's regular investment banker.

In the course of its leasing business, Taxpayer regularly disposes of depreciable tangible property and regularly acquires new property that, you represent, is like-kind. Taxpayer wishes to implement the following program of like-kind exchanges under section 1031, which will result in the deferral of tax associated with gains realized upon

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disposal of such assets. Taxpayer seeks to reconcile the requirements of section 1031 with its long established business practices. Taxpayer maintains a portfolio of equipment manufactured by Parent or a subsidiary of Parent, which Taxpayer purchases from sellers. All such equipment owned by Taxpayer is leased to third parties and held for productive use in its business. The lease transactions subject to this ruling request are only those leases in which Taxpayer holds legal title to and depreciates the equipment pursuant to section 168. Taxpayer maintains its records for outstanding leases on a specific lease accounting software system ("Lease System").

In a majority of current equipment purchase transactions and many sales transactions, Taxpayer's counterparty is a dealer. These transactions include sales of equipment from Taxpayer's lease portfolio at the end of a lease and purchases of equipment in connection with the initiation of a new lease. Where a dealer is the buyer or seller of equipment, amounts receivable by Taxpayer on sales or payable on purchases are netted between the dealer, Parent and Taxpayer. You represent that none of the dealers who engage in such transactions with Taxpayer are related persons with respect to Taxpayer within the meaning of section 1031(f)(3). Dealers generally acquire new equipment from Parent or one of Parent's subsidiaries with title passing to the dealer. The equipment purchased by Dealer is initially financed through floor plan financing provided by Parent or a subsidiary other than Taxpayer.

In all of its leasing divisions, Taxpayer acquires the overwhelming majority of equipment purchased at initiation of leases from a dealer. Dealers apply to participate in the leasing program for certain divisions, including Division 1 and Division 2. When a dealer identifies a potential equipment lessee, the dealer will negotiate a price for the equipment; arrange for standard form lease documents to be processed through Taxpayer; and transmit such forms to Taxpayer. Taxpayer inputs the lease application information into its Lease System and reviews the lessee's credit rating. Taxpayer then approves or rejects the lease application. Upon approval, Taxpayer prepares lease documents for both Equipment A leases and Equipment B leases based upon Parent's Master Lease Agreement.

The lease documents and certain documents evidencing transfer of the equipment's ownership from the dealer to the Taxpayer are returned to the dealer for execution by the lessee and the dealer. After the lessee signs the lease and the dealer signs the documents evidencing transfer of ownership, both are returned to Taxpayer for final approval and input into the Lease System. Upon acceptance of a lease by Taxpayer, title to and ownership of the equipment passes to Taxpayer and the lease is activated. The Lease System records a booking date. Corresponding internal accounting entries are created and a credit for the equipment purchase is placed on the Account maintained for that dealer with Parent. Taxpayer will not tender funds on an equipment purchase from a dealer. Lease originations are recorded daily. (Taxpayer follows the same procedure for purchases of equipment subject to lease initiation from parties other than dealers, except that payment for such equipment is generally in the

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form of cash transfer by check, wire transfer or automated clearing house (“ACH”) deposit to the account of the seller.)

Lease terms for Equipment A and Equipment B leases range from three to five years. Included in the lease is a purchase option allowing the lessee to acquire ownership of the equipment from Taxpayer for a purchase price that is either (i) a preset amount stated in the lease; (ii) a payoff amount calculated according to a formula stated in the lease; or (iii) the fair market value of the equipment at lease termination. Upon exercise of the purchase option, payment for the equipment is made to Taxpayer by check, wire transfer or ACH deposit to accounts maintained by Taxpayer in third party depository institutions. If the lessee does not purchase the equipment, Taxpayer grants the dealer who originated the lease the option to buy the equipment. If that dealer does not purchase the equipment, Taxpayer generally will make the equipment available to other dealers and then to third parties for purchase. If the originating dealer or another dealer wants to purchase equipment coming off lease, a member of Parent’s group may extend credit to the purchasing dealer. When Parent debits the Account for the purchase amount, the dealer is deemed to own the equipment under terms of certain Master Dealer Agreements with Parent for Equipment A or for Equipment B. Taxpayer is credited with receipt of the sales price.

As stated above, Parent maintains an Account for each dealer into which it records all sales and purchases of Parent’s equipment. This account also reflects all other activities of the dealer with any entity affiliated with the Parent such as charges for services, finance costs, and promotion credits. For each sale to a dealer by Parent or a subsidiary of Parent, including Taxpayer’s sales at lease termination, Parent debits the Account of such dealer for the price of the equipment plus applicable taxes. The debit reflects (i) the dealer’s debt to Parent or the selling subsidiary for the purchase price, and (ii) that the dealer owns the equipment. Offsetting credit entries to the dealer’s Account arise from a dealer’s sales of equipment to Taxpayer in connection with lease originations or from other credits relating to the dealer’s transactions with members of Parent’s group. The terms of this Account require that any current balance be settled by the dealer monthly by Date A for all activity occurring during the previous month relating to Parent and its subsidiaries. The settlement for the debits between Parent and its subsidiaries, including Taxpayer, is made concurrent with and through a certain monthly closing process. The terms of Taxpayer’s receivables and payables reflected by debits and credits to the Account for the dealer do not exceed x Days.

Documents involving lease plans and terms for both the Equipment A and Equipment B specifically provide, “if the equipment is purchased [by the dealer] and the lease is accepted by [the Taxpayer], then the purchase price plus applicable taxes will be credited to the dealer’s account with [Parent] and used to offset currently due indebtedness of the dealer to [Parent].” When a lease is initiated through Taxpayer’s purchase of equipment from a dealer, Parent treats Taxpayer as incurring a liability to Parent to purchase the equipment. Taxpayer’s offsetting credits are created when it

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sells off-lease equipment to a dealer. Parent applies net dealer credit balances towards repayment of that dealer's obligations to other members of Parent's group arising from goods or services purchases or other charges. Members of Parent's group other than Taxpayer may also extend credit to dealers when the dealer wants to purchase equipment coming off lease, and will remit payment directly to Taxpayer at the direction of the dealer.

Taxpayer is restructuring its leasing operations with the intention that the disposition to an unrelated party of Equipment A or Equipment B coming off lease and upon which a gain is realized by Taxpayer ("Relinquished Property") and the acquisition by Taxpayer of Equipment A or Equipment B respectively from a dealer at the initiation of a lease ("Replacement Property") will qualify as a like-kind exchange under section 1031. Once it initiates this exchange program, Taxpayer expects that multiple exchanges of both types of equipment will commence every month. You represent that Taxpayer will exchange Equipment A only for Equipment A of the same Standard Industrial Classification Code and Equipment B only for Equipment B of the same Standard Industrial Classification Code.

Disposition of Relinquished Equipment

To meet the requirements of section 1031, Taxpayer entered into a Master Exchange Agreement with QI, under which QI is to act as the qualified intermediary under section 1.1031(k)-1(g)(4) of the Income Tax Regulations. In addition, Taxpayer proposes to engage the services of Escrow Holder as depository for a qualified escrow account as defined in section 1.1031(k)-1(g)(3) to effect the proposed exchanges in order to avoid being deemed in actual or constructive receipt of the proceeds from the sales of Relinquished Property which are to be applied towards the purchase of Replacement Property. Accordingly, Taxpayer is assigning its rights under existing leases to the sale of all leased equipment (Relinquished Property) owned by Taxpayer for certain outstanding leases. Thereafter, and on a periodic basis, Taxpayer will assign to the QI its rights to sell the leased equipment to lessees. This Master Exchange Agreement provides for the QI's blanket acceptance of all assignments by Taxpayer of its rights under contracts to sell equipment which will constitute Relinquished Property in an exchange.

Lessees will be advised in writing of the assignment of the Taxpayer's sales rights to the QI at the same time the lessee is given a payoff quote and the requirement that equipment purchase payments be remitted to the QI. If a lessee declines to exercise its purchase option and a dealer wants to purchase equipment coming off lease, the purchasing dealer will call Taxpayer for a payoff quote. If the dealer decides to purchase the equipment, the Sales Agreement will inform the dealer that Taxpayer will be assigning its right to sell the equipment to the QI. The consent by the dealer to the assignment of the Taxpayer's right to the QI is also included in this Sales

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Agreement. A similar procedure will be followed where a nondealer third party other than a lessee is the purchaser of the equipment.

After a Sales Agreement is executed by a purchaser and returned to Taxpayer, Taxpayer will execute the Sales Agreement and concurrently assign its rights to the QI on the form incorporated into the Sales Agreement. Taxpayer will then create a journal voucher containing the payoff information. This journal voucher and Sales Agreement will be received by Taxpayer's accounting department, which will confirm to the QI in writing Taxpayer's assignment of rights to sell the specific equipment and to collect the corresponding consideration. The accounting department will then make specific entries into the Lease System, which will terminate the specific lease. The internal accounting represented by posting the journal vouchers will be batched each business night and will post a debit to the Account for the purchasing dealer. The posting of this debit is treated by Taxpayer and the dealer as creating a receivable and transferring title to the Relinquished Property to the dealer. Legal ownership, however, remains with Taxpayer until the QI completes the sale of the Relinquished Property. For purchases by a lessee or dealer outside the Account process, the sale is deemed complete when the purchase proceeds are received by the QI and deposited into the Escrow Account. Taxpayer will confirm the equipment sale with the QI by transmitting a summary schedule of equipment sales to the QI. As a consequence of its sale of equipment on credit, the QI will hold the receivable from the dealer, which is reflected as a debit on the Account for the dealer. The QI will assign the receivable to another company within the Parent group in exchange for payment to QI of the face amount of the receivable pursuant to Agreement A below.

Taxpayer will also record disposition of the equipment within its proposed like-kind exchange asset software. This sale date commences the Identification Period and the Exchange Period with respect to the property which is determined to be Relinquished Property under the terms of Taxpayer's Exchange Agreement.

Acquisition of Replacement Equipment

You represent that Taxpayer expects that all exchanges will take place within the Identification Period required by section 1031(a)(3) as applicable to each respective Relinquished Property. However, Taxpayer may determine to extend its replacement period timing up to and including the end of the applicable Exchange Period for a specific Relinquished Property, subject to proper identification of Replacement Property pursuant to the requirements in section 1.1031(k)-1(c) of the regulations. Taxpayer's processing of Replacement Property acquisitions will generally follow the procedures applicable to its equipment purchases until a prospective lessee's credit is approved.

The lease documentation to be sent by Taxpayer to a dealer will include a certain Sale form for execution by the dealer, which will provide (i) the terms of the purchase of the equipment by Taxpayer from the dealer, (ii) that Taxpayer will assign its

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purchase rights to the QI, and (iii) that the dealer consents to the assignment. The Master Exchange Agreement provides for the QI's blanket acceptance of all assignments by Taxpayer of its rights under contracts to purchase equipment which will constitute Replacement Property in an exchange.

The business day after sending new lease documentation to the dealer, a summary of the approved lease will be sent to the QI confirming Taxpayer's assignment of its right to purchase the equipment subject to the new lease agreements. The notification form will include the equipment's cost and a specific description, but advises that the actual purchase is to be deferred pending Taxpayer's receipt and approval of executed documentation. Upon Taxpayer's receipt of lease documentation executed by a lessee and the Sales form executed by the dealer, Taxpayer reviews the documents to verify that they conform to the approved transaction. If the documents are proper, Taxpayer will execute the lease and ownership of the equipment passes to Taxpayer at that time. The new lease is activated in the Lease System.

Each business day, Taxpayer will prepare a summary of the leases entered into the Lease System and executed the previous business day and will forward the summary to QI. The summary verifies purchases of equipment by QI, and therefore QI's obligation to pay consideration to the equipment sellers. Funding to pay for Replacement Property will come from Subaccount D maintained by Escrow Holder, pursuant to joint instructions from Taxpayer and QI. This may be by wire transfer, ACH transfer or check drawn on the account. To the extent that the proceeds from the sale of Relinquished Properties are insufficient to cover the purchase price of corresponding Replacement Properties, Taxpayer will direct QI to use the disposition proceeds that were previously designated as Non-Qualified Proceeds and held in the Escrow Account, or, Taxpayer will transfer additional funds into the Escrow Account.

Exchange Agreement

Taxpayer will enter into the Exchange Agreement with QI pursuant to which the QI agrees to acquire and transfer equipment owned by Taxpayer (*i.e.*, Relinquished Property) to various buyers (lessees, dealers or other third parties) in consideration of, and in exchange for, the acquisition of like-kind equipment (*i.e.*, Replacement Property) from various sellers to QI and the subsequent transfer of such Replacement Property to Taxpayer. Taxpayer will assign to QI all its rights to sell all of its Equipment A and Equipment B and its rights to purchase Replacement Property.

The Exchange Agreement provides that in any disposition of property where Taxpayer extends credit to the buyer, the QI shall, at Taxpayer's direction, assign the resulting receivable to a third party in return for consideration equal to the full face amount of the receivable. It is anticipated that such assignments will be made to members of Parent's group. Payment for assigned receivables is to be made to the QI within several days of the creation of the receivable. Terms for the purchase of QI

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receivables are reflected in Agreement A which Taxpayer proposes will be implemented between a member of Parent group and QI. Any other sales of receivables would be pursuant to substantially identical terms. Further, the Exchange Agreement provides that in any equipment acquisition in which the seller extends credit to QI, as Taxpayer's assignee, QI's obligations shall, at Taxpayer's direction, be assigned to and assumed by a third party member of Parent group pursuant to Agreement A immediately after completion of the purchase by QI as Taxpayer's assignee. These assignments convert receivables and payables into funding which allows QI to purchase new equipment and allows the dealer obligations to be ultimately settled through Account X consistent with its longstanding practice.

You represent that the Exchange Agreement is intended to serve as the written agreement governing the QI's role in all exchanges contemplated by Taxpayer, as required by section 1.1031(k)-1(g)(4)(iv) of the regulations. The Exchange Agreement provides that QI may act as a collection and disbursement agent with respect to sales proceeds of leased Equipment A and Equipment B, which do not constitute Relinquished Property in a like-kind exchange. This procedure is adopted due to administrative hardship that would be associated with the internal segregation of the processes for collection of Relinquished Property sales proceeds from the processes for collection of proceeds from sale of equipment coming off lease which will not be transferred in a like-kind exchange.

Escrow Agreement

Taxpayer, QI and Escrow Holder will enter into Escrow Agreement, which establishes terms for creating an Exchange Fund. The Escrow Agreement provides that Taxpayer is or will be the owner of the Relinquished Property [ies] and other properties that Taxpayer intends to have QI sell to third party buyers as Taxpayer's agent pursuant to the Exchange Agreement. Proceeds from sales of Relinquished Property [ies] will be deposited into the Exchange Fund with the Escrow Holder and will be subject to the terms and conditions of the Escrow Agreement.

Escrow Agreement provides that the Escrow Holder will maintain Subaccounts within the Exchange Fund for collection and retention of funds received by QI from sales of Taxpayer's equipment. All proceeds received by QI from parties other than Parent are expected to be deposited into Subaccount A. Once the source of funds in Subaccount A can be identified as the proceeds from sales of Equipment A or sales of Equipment B, these funds will be separated and transferred into either Subaccount B or Subaccount C, which are established to segregate such proceeds respectively for administrative purposes. Relinquished Property proceeds and all investment earnings thereon are to be generally maintained in one of these subaccounts. Proceeds received pursuant to Agreement A will be deposited directly into one of these subaccounts as the type of equipment for which the payment is due will be known at the time of the payment. Subaccount D will also be established for Equipment A and

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Equipment B. All disbursements to purchase Replacement Properties will be made from Subaccount D. Accordingly, it is possible for funds derived from a sale of a Relinquished Property which constitutes Equipment A to be utilized by the QI to satisfy its obligations to purchase Relinquished Property which constitutes Equipment B (or vice versa). However, all exchange credits must ultimately balance under terms of the Exchange Agreement on a property by property basis. This structure is intended to assure that Relinquished Property sales proceeds and income derived from those proceeds remain at all times subject to the conditions imposed by section 1.1031(k)-1(g)(6) of the regulations.

Escrow Agreement contains a provision that specifies that Taxpayer shall direct Escrow Holder to invest proceeds held in Subaccount B or Subaccount C, and that any interest or income thereon shall belong solely to QI. The investments will not be made in any security of Taxpayer or any affiliates of Taxpayer. If Taxpayer determines that Escrow Holder is a qualified escrow holder under section 1.1031(k)-1(g)(3)(ii)(A) of the regulations, Taxpayer can by written notice to QI and Escrow Holder require that interest and other amounts or benefits earned in lieu of the payment of interest on the fund belong to Taxpayer. In addition, under Escrow Agreement, Taxpayer has the right to transfer funds between any of the Subaccounts within the Escrow Fund. However, funds cannot be disbursed from Subaccount D within the Escrow Fund without the joint authorization of Taxpayer and QI.

Taxpayer does not have the right to receive, pledge, borrow, or otherwise obtain benefit of any of the exchange proceeds or any other benefits earned in lieu of interest, held or otherwise provided by either QI or Escrow Holder before the end of the exchange period, or, if earlier, the end of the identification period without the corresponding Replacement Property having been identified or received by Taxpayer.

Escrow Agreement also contains a provision that provides that Escrow Holder shall furnish Taxpayer and QI with direct access to Subaccount D for the purpose of making disbursements from Subaccount D. Such direct access may be by paper means, including, without limitation, single or two party negotiable checks by telephone or by electronic means, including, without limitation, access via specialized software, telephone modem dial in, Internet, or by telephone. Taxpayer and QI hereby represent and warrant that neither party shall cause the disbursement of any funds from Subaccount D without due authorization from the other party.

Agreement A

Taxpayer proposes that QI and Company enter Agreement A which permits the conversion into liquid funds of receivables and payables created on QI's sales of Relinquished Property [ies] and purchases of Replacement Property [ies] to and from dealers. Under Agreement A, Company will purchase QI's receivables from dealers at

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par (that is, with no premium or discount) and will assume QI's payables to dealers at par in connection with QI's services as qualified intermediary in this program.

These purchase and assumption transactions will occur periodically. QI will provide supporting information relating to the receivables and payables created in equipment purchase and sale transactions on behalf of Taxpayer. Company is to remit payment to QI for receivables acquired by Company, and QI is to remit payment to Company for payables transferred to Company. In each case, payment is to be made within two business days after notice and supporting documentation is provided by QI. Funds paid by Company will be deposited into either Subaccount B or Subaccount C within the Escrow Fund held by Escrow Holder, depending upon the type of equipment whose sale created the receivable. Funds due to Company will be paid from Subaccount D within the Escrow Fund maintained by Escrow Holder.

Agreement A is intended to allow Parent's group to account for dealer purchases and sales of equipment through the longstanding dealer account system, while allowing Taxpayer and QI to proceed with the like-kind exchange of Taxpayer's equipment independent of such account processing. You represent that no net economic benefit to Parent, Company, or QI will occur due to the payment for receivables and assumption of payables at par.

Restrictions on Taxpayer's Rights to Relinquished Property Sales Proceeds

The Exchange Agreement and the Escrow Agreement expressly limit Taxpayer's rights to amounts held in the Exchange Fund and its Subaccounts. Under the Exchange Agreement, upon receipt of any funds by QI on the transfer of possible Relinquished Property [ies] to a buyer, QI is obligated to immediately transfer such funds to Escrow Holder for deposit into the Exchange Fund Subaccounts. Any funds held by QI pending their transfer to Escrow Holder and funds held in the Subaccounts maintained by Escrow Holder shall be used solely to enable QI to perform its obligations to acquire Relinquished Property [ies]. The Exchange Agreement further provides that Taxpayer will not have any rights to receive, borrow, pledge or otherwise obtain the benefits of monies held in the Escrow Fund with respect to any Relinquished Property until the end of (i) the applicable "Exchange Period" or, if earlier, (ii) the end of the applicable "Identification Period" if no Replacement Property [ies] are identified or received by Taxpayer. In no event shall funds be disbursed by Escrow Holder until Escrow Holder receives a written notice signed jointly by QI and Taxpayer.

Escrow Agreement provides that all funds held by Escrow Holder derived from the sale of Relinquished Property [ies] or any interest or benefits in lieu of interest earned thereon ("Exchange Proceeds") are subject to the limitation that Taxpayer will not have any right to receive, pledge, borrow, or otherwise obtain the benefit of the Exchange Proceeds until the end of (i) the applicable "Exchange Period" or, if earlier,

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(ii) the applicable "Identification Period" if no Replacement Property [ies] are identified or received by Taxpayer.

Exchange Agreement and Escrow Agreement both define Identification Period for each Relinquished Property as the period beginning on the date Taxpayer transfers that property and ending at midnight of the 45th day thereafter. Exchange Period is defined with respect to each Relinquished Property as beginning on the date Taxpayer transfers that property and ending on midnight on the earlier of the 180th day thereafter or the due date (with extensions) for Taxpayer's federal income tax return for the year in which the transfer of the Relinquished Property occurred.

In addition, all Exchange Proceeds are initially held in Subaccount A or in either Subaccount B or Subaccount C. Amounts held in either Subaccount B or Subaccount C may not be disbursed except to Subaccount D. If identified as Relinquished Property Proceeds, amounts held in Subaccount D are not to be disbursed, except in connection with the acquisition of Replacement Property [ies], prior to the end of the applicable Exchange Period, or, if earlier, the applicable Identification Period if there are no remaining identified properties with respect to a specific Relinquished Property. However, no amounts will be disbursed from Subaccount D unless joint authorization from both the Taxpayer and the QI is received by the Escrow Holder.

REQUESTED RULINGS

1. Each transfer by the Taxpayer of Relinquished Property and the receipt of Relinquished Property in accordance with Exchange Agreement will constitute a transaction that qualifies for deferral of gain recognition for federal income tax purposes as a like-kind exchange pursuant to section 1031 of the Code.
2. Acting in accordance with the Exchange Agreement, the Escrow Agreement, section 1031 of the Code and the regulations thereunder, the QI will be treated as acquiring and transferring both the Relinquished Property and the Relinquished Property with respect to each exchange.
3. Pursuant to section 1.1031(k)-1(f)(1) of the regulations, the Taxpayer will not be in constructive receipt of any money or other property held by QI or Escrow Holder, including amounts derived from sales of receivables to Parent or other affiliates of Taxpayer, unless such items are actually payable to and deposited by the Taxpayer as long as the requirement of the Exchange Agreement, the Escrow Agreement and the Taxpayer's representations herein are met.

LAW AND ANALYSIS

Section 1031(a)(1) of the Code provides that in general, no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business

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or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1.1031(k)-1(a) of the regulations provides that a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In order to constitute a deferred exchange, the transaction must be an exchange (i.e. a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of section 1.1031(k)-1 are satisfied.

Section 1031(a)(3) states that any property received by the taxpayer shall be treated as property that is not like-kind property if (a) such property is not identified as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (b) such property is received after the earlier of (i) the day that is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange or (ii) the due date (determined with regard to extension) for transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs. Section 1.1031(k)-1(c) of the regulations provides that any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period..

Section 1.1031(k)-1(f)(1) provides that a transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or other property. In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. Section 1.1031(k)-1(f)(1) further provides that if the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

Section 1.1031(k)-1(f)(2) provides that except as provided in paragraph (g) of this section (relating to safe harbors), the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual and constructive receipt and without regard to the

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taxpayer's method of accounting. Section 1.1031(k)-1(f)(2) further explains that the taxpayer is in actual receipt of the money at the time the taxpayer actually receives the money or receives the economic benefit of the money. The taxpayer is in constructive receipt of money or property at the time the money or other property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given.

Section 1.1031(k)-1(g)(1) provides that there are four safe harbors, the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money for purposes of section 1031.

Section 1.1031(k)-1(g)(4) provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether taxpayer is in actual or constructive receipt of money before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

However, section 1.1031(k)-1(g)(4) only applies if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary, as provided in paragraph (g)(6) of this section.

Section 1.1031(k)-1(g)(4) further provides that a qualified intermediary is a person who is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and enters into a written agreement with the taxpayer (the "exchange agreement") and acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

Section 1.1031(k)-1(g)(6) provides that an agreement limits a taxpayer's rights as provided in the paragraph (g)(6) only if the agreement provides that the taxpayer has no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period established by section 1031(a)(3)(B) except that under (ii) the agreement may provide that the taxpayer may have rights to the money or other property if at the end of the identification period, the taxpayer has not identified replacement property or (iii) the agreement may provide that if the taxpayer has identified replacement property, the taxpayer may have rights to the money or other property upon or after (A) the receipt by the taxpayer of all replacement property to which it is entitled under the exchange agreement or (B) the occurrence after the end of the identification period of a material and substantial contingency that

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relates to the deferred exchange, is provided for in writing, and is beyond the control of the taxpayer.

Section 1.1031(k)-1(k)(1) provides that for purposes of this section, a disqualified person is a person described in paragraph (k)(2), (k)(3), or (k)(4) of this section.

Section 1.1031(k)-1(k)(2) provides that a person is a disqualified person if the person is the agent of the taxpayer at the time of the transaction. For this purpose, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. Solely for purposes of this paragraph, performance of the following services will not be taken into account –

- (i) Services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031; and
- (ii) Routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

Section 1.1031(k)-1(g)(3)(i) provides that in the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured by cash or a cash equivalent if the cash or cash equivalent is held in a qualified escrow account. Under paragraph (ii) of this section, a qualified escrow account is an escrow account wherein the escrow holder is not the taxpayer or a disqualified person, and the escrow agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account.

There are three general requirements for nonrecognition treatment under section 1031: (1) both the property surrendered and the property received must be held either for productive use in a trade or business or for investment; (2) the property surrendered and the property received must be of "like-kind;" and (3) there must be an exchange as distinguished from a sale and a purchase.

Taxpayer's position is that its transactions pursuant to the above program will qualify as separate deferred like-kind exchange transactions because the Relinquished and Replacement Properties will be like-kind, will be held by Taxpayer for productive use in its business, and will be exchanged for other properties. In its submission, Taxpayer represents that the properties will be like-kind because each piece of equipment exchanged will be in the same product class as listed in the Standard

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Industrial Classification manual (and Taxpayer has provided a list of such equipment and the corresponding SIC codes). Moreover, the relevant qualified use of the property owned by Taxpayer and subsequently being exchanged in the transaction is the leasing of such property to third parties. Thus, the Relinquished Property that Taxpayer previously leased to third parties and the Replacement Property that Taxpayer will be leasing to third parties upon acquisition are considered property held for productive use in a trade or business in Taxpayer's hands. In addition, the properties will be exchanged, not sold and purchased, because the Taxpayer will use a qualified intermediary to receive and control the proceeds derived from dispositions of Relinquished Property until Replacement Property is identified and acquired.

In the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and repurchase, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. Actual or constructive receipt of money or other property by an agent of the taxpayer is actual or constructive receipt by the taxpayer.

Section 1.1031(k)-1(g) of the regulations sets forth four safe harbors, the use of any of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for section 1031 purposes. In the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the taxpayer's agent for section 1031 purposes. In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

In the instant case, Taxpayer will enter agreements with QI and other parties to the transaction and will assign to QI its rights to sell the Relinquished Property [ies] and to purchase Replacement Property [ies]. QI is not an agent of Taxpayer in connection with exchanges of Relinquished Property [ies] and Replacement Property [ies] because their relationship is intended solely to meet the safe harbor provisions of the above regulations. QI is not Taxpayer nor a disqualified person because QI is not Taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker. QI and Taxpayer had no prior relationship, and QI is not related to Taxpayer under section 267(b) or 707(b) of the Code. Although QI will not be acquiring legal title to any properties, pursuant to section 1.1031(k)-1(g)(4)(iv) QI is treated as acquiring a Relinquished Property from Taxpayer and transferring the Relinquished Property to a party other than Taxpayer if QI enters into agreements to acquire and transfer the

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Relinquished Property to a party other than Taxpayer and pursuant to such agreements the Relinquished Property is transferred to that party.

Pursuant to section 1.1031(k)-1(g)(4)(v), an intermediary is treated as entering into an agreement if the rights of a party to an agreement are assigned to the intermediary and all parties to the agreement are notified in writing of the assignment on or before the date of the relevant transfer of the property. In this case, in all instances, Taxpayer will assign to QI the Taxpayer's right to sell each item of Relinquished Property. Moreover, with respect to any sales to lessees, Taxpayer will notify QI of its assignment of rights to sell the property under the terms of the leases. In the case of a dealer (or another purchaser who is not a dealer or lessee) the notice of Taxpayer's assignment of its sale rights will be contained in the sales agreement transmitted by Taxpayer to purchaser and thus such purchasers will receive written notice of the Taxpayer's assignment of sales rights to QI prior to the time that the Relinquished Property is transferred to the purchaser. Specific confirmation of Taxpayer's assignment of sales rights will be transmitted to the QI prior to or concurrent with completing the sales transaction via the notification to QI of the property sales.

Pursuant to section 1.1031(k)-1(g)(4)(iv) and (v), QI is treated as acquiring Replacement Property from a party other than Taxpayer and transferring the Replacement Property to Taxpayer if it enters into agreements with a third party to acquire and transfer the Replacement Property to Taxpayer and pursuant to that agreement the Replacement Property is transferred to Taxpayer. The QI is treated as entering into agreements to acquire and transfer Replacement Property if rights of Taxpayer to purchase the property are assigned to QI and the parties to the transaction are all notified in writing before the transfer. In this case, under the Exchange Agreement, the QI is assigned all Taxpayer's purchase rights relating Replacement Properties. Confirmation of specific Replacement Properties which QI is to acquire by assignment of Taxpayer's rights is accomplished through dispatch of the Notice of Assignment of Purchase Rights transmitted after lease documentation is sent to a dealer and before a purchase is completed. For purchases from dealers or third parties, Taxpayer will notify the seller of its assignment of purchase rights to QI as part of the lease documentation.

Accordingly, we conclude that pursuant to the above regulations, QI, acting in accordance with the Exchange Agreement, will be treated as a qualified intermediary and will be treated as acquiring and transferring each Relinquished Property and each Replacement Property.

Concerning Taxpayer's right to receive cash or cash equivalents from Escrow Holder, we note that as mandated by section 1.1031(k)-1(g)(3)(ii)(B), the Escrow Agreement contains certain restrictions required by section 1.1031(k)-1(g)(6), including the requirement that joint authorization by Taxpayer and QI is necessary in order to release amounts in Subaccount D.

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In addition, the Exchange Agreement requires QI to transfer any funds received upon the transfer of any property to the accounts established by Escrow Holder. As required by the regulations, the Exchange Agreement further provides that Taxpayer will have no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property with respect to Relinquished Property or earnings derived therefrom prior to the end of the Exchange Period or, if earlier, the end of the Identification Period if there are no identified Replacement Properties which have not been acquired. Proceeds from the sale of Relinquished Property are deposited into the appropriate Subaccount. Similarly, procedures applicable to the Escrow Fund and Subaccounts pursuant to the Escrow Agreement assure that Taxpayer will not have the right to pledge, borrow, or otherwise obtain the benefits of money or other property derived from the transfer of a Relinquished Property prior to the expiration of the conditions in section 1.1031(k)-1(g)(6).

The Escrow Agreement also contains procedures for disbursements from Subaccount D which comply with the safe harbor limitations in section 1.1031(k)-1(g)(3) and (6). For instance, Escrow Agreement specifically provides that Taxpayer and QI represent and warrant that neither party shall cause the disbursement of any funds from Subaccount D without due authorization from the other party. Thus, once received, amounts can be disbursed from Subaccount D only by the joint authority of QI and Taxpayer. Accordingly, Taxpayer does not have the unfettered discretion to disburse funds from Subaccount D. Moreover, until the end of the Exchange Period or, if earlier, the end of the Identification Period for any Relinquished Property if there are no identified Replacement Properties which remain to be acquired, QI may not direct Escrow Holder to disburse amounts to Taxpayer. Therefore, we conclude that Taxpayer does not have actual or constructive receipt of the amounts held in Escrow Fund. Taxpayer also is not in actual or constructive receipt of proceeds from the sale or exchange of property when Taxpayer directs the transfer of funds between the Subaccounts within Escrow Fund because this does not result in any benefit to Taxpayer but instead allows an administrative audit trail of the proceeds from Relinquished Equipment A Property and Relinquished Equipment B Property.

Concerning Agreement A, which provides for sale by QI of receivables created when dealer purchase equipment from QI and for assumption by Company of obligations of QI to dealers created when QI purchases equipment from dealers, there is no netting of such sales and purchase transactions in this process. Each dealer receivable and payable will be separately settled between QI and Company by a transfer of funds to or from Escrow Fund. Conversion of the receivables and payables to cash at par through this system does not result in any net economic benefit to Company or Taxpayer. Company must pay full value for payables it assumes, and it receives full value for receivables it acquires. The above restrictions on Taxpayer's rights "to receive, pledge, borrow or otherwise obtain the benefits of money or other property" are intended to prevent Taxpayer from directly or indirectly utilizing the Relinquished Property sales proceeds for purposes other than acquiring Replacement

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Property during periods such proceeds are held in a qualified escrow or by a qualified intermediary. A transaction between a taxpayer and a qualified intermediary which produces no net benefit to the taxpayer is not considered to violate these strictures. This process does not result in the Taxpayer being deemed in actual or constructive receipt of money or other property.

CONCLUSIONS

1. We conclude that each transfer by the Taxpayer of Relinquished Property and the receipt of Relinquished Property in accordance with the Exchange Agreement will constitute a transaction that qualifies for deferral of gain recognition for federal income tax purposes as a like-kind exchange pursuant to section 1031 of the Code.
2. We conclude that as long as QI acts in accordance with the Exchange Agreement, the Escrow Agreement, section 1031 of the Code and the regulations thereunder, it will be treated as acquiring and transferring the Relinquished Property and Relinquished Property with respect to each exchange.
3. We conclude that pursuant to section 1.1031(k)-1(f)(1) of the regulations, the Taxpayer will not be in constructive receipt of any money or other property held by QI or Escrow Holder, including amounts derived from sales of receivables to Parent or other affiliates of Taxpayer, unless such items are actually payable to and deposited by the Taxpayer as long as the requirement of Exchange Agreement, the Escrow Agreement and the Taxpayer's representations are met.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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Sincerely,
Robert M. Casey
Senior Technician Reviewer
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

cc: