Dear [Name]:

This responds to your letter, dated August 16, 2002, requesting rulings on the proper federal income tax treatment of certain exchanges of personal property under Taxpayer’s Like-Kind Exchange Program (LKE Program).
APPLICABLE FACTS:

Background Information.

Taxpayer is a State A corporation whose businesses include the buying, selling and leasing of mx. Taxpayer purchases leases and the related leased mx from dd with whom it has dd agreements in place (Ee). It derives income from receiving and processing lease payments as a lessor and providing other services incidental to the mx leasing business.¹

Taxpayer also realizes gain from dispositions of leased mx as the leases terminate. A lease terminates when, for example, the lease term expires; the leased mx is damaged beyond repair; the lessee defaults on the lease and the leased mx is repossessed; or the lessee purchases the leased mx prior to the expiration of the lease term. Methods of disposition of leased mx include:

1. Scope of Taxpayer’s LKE Program.

Taxpayer plans to implement its LKE Program under §1031 of the Internal Revenue Code and the Income Tax Regulations thereunder with respect to many of its dispositions and acquisitions of leased mx. The LKE Program will involve most of the leased mx acquired and disposed of by Taxpayer’s subsidiaries. Leased mx for which most or all of the disposition proceeds are insurance proceeds will be excluded from the LKE Program.

Leased mx will be designated automatically for inclusion in the LKE program according to a predetermined set of LKE Program parameters. Taxpayer will be allowed to change these parameters from time to time, but only on a prospective basis. The initial parameters will be set forth in writing and may include basic criteria, such as make and model, as well as other criteria designed to fit within Taxpayer’s financing arrangements and other circumstances. Leased mx meeting the LKE Program parameters that are disposed of pursuant to the LKE Program constitute “Relinquished Property” (RQ). Leased mx meeting the LKE Program parameters that are acquired pursuant to the LKE Program constitute “Replacement Property” (RP).

2. The Qualified Intermediary.

Taxpayer and its subsidiaries holding title to leased mx will enter into a Master

¹ The leases and titles to the leased mx are held by subsidiary entities of Taxpayer.
Exchange Agreement with a party intended to qualify and function as a qualified intermediary within the meaning of §1.1031(k)-1(g)(4) of the regulations (the QI). The QI will function as an intermediary to facilitate exchanges of the leased mx designated for inclusion in the LKE Program. In the Master Exchange Agreement, Taxpayer will assign to the QI Taxpayer’s rights (but not its obligations) under the contracts entered into by Taxpayer with respect to the disposition of RQ, and QI will use proceeds from the disposition of RQ to pay the purchase price with respect to leased mx purchased from “Ee” pursuant to the LKE Program. The Master Exchange Agreement is intended to qualify as a written exchange agreement described in §1.1031(k)-1(g)(4)(iii)(B).

The QI will be a newly formed, wholly owned subsidiary of an entity (the “QI Administrator”) that Taxpayer selects to oversee the QI functions associated with the LKE Program. QI will be a limited liability company that will not elect to be treated as an association or corporation. The QI Administrator will be a wholly owned subsidiary of a bank within the meaning of §581. The principal activity of both the QI and the QI Administrator will be rendering services to facilitate exchanges of property intended to qualify for nonrecognition of gain under §1031. The QI Administrator also will be a party to the Master Exchange Agreement.

In the two years preceding the inception of the LKE Program, neither the QI nor the QI Administrator has acted as Taxpayer’s employee, attorney, accountant, real estate agent or broker, or investment banker or broker. In fact, neither the QI nor the QI Administrator has performed any services in the past two years for Taxpayer. Further, while acting as Taxpayer’s qualified intermediary, neither the QI nor the QI Administrator will perform any services for Taxpayer other than permitted, non-disqualifying services described in §1.1031(k)-1(k)(2)(i) and (ii).

None of the affiliates of either the QI or the QI Administrator has, in the past two years, performed services for Taxpayer. Further, none of the affiliates of either the QI or the QI Administrator will perform any services for Taxpayer or its affiliates while QI is acting as Taxpayer’s qualified intermediary, other than those permitted under §1.1031(k)-1(k)(2) and investment banking or brokerage services permitted under §1.1031(k)-1(k)(4)(ii).

Taxpayer will structure its LKE Program to meet the requirements of the “qualified intermediary” safe harbor under §1.1031(k)-1(g)(4), including the assignment and notice requirements.

3. Assignment and Notification Procedures for RQ.

Pursuant to the Master Exchange Agreement, Taxpayer will make a blanket assignment to the QI of Taxpayer’s rights (but not its obligations) under contracts entered into by Taxpayer with respect to the disposition of RQ. Under the Master Exchange Agreement, such assignment will become effective automatically with respect to any RQ
immediately prior to the disposition of such RQ. The assignment will apply to rights with respect to the portfolio of leased mx held by Taxpayer’s subsidiaries on the date of execution of the Master Exchange Agreement, as well as to leased mx acquired by Taxpayer in the future. Taxpayer will provide the QI a list of RQ to be sold under sales contracts assigned to the QI.

Before the inception of the LKE Program, Taxpayer will send to all Ee a bulletin outlining the LKE Program (the “Dd Bulletin”). The Dd Bulletin will include a notice to the effect that Taxpayer has assigned to the QI all of its rights (but not its obligations) under contracts entered into by Taxpayer with respect to the disposition of RQ. The Dd Bulletin will further provide a payment procedure for all acquisitions and dispositions. Dd will be directed to make all checks payable to the QI and to direct all wire transfers and ACH payments to the Local Account, which will be a joint QI/Taxpayer account.\(^2\) New Ee will receive notification via . In the case of leased mx disposed of by , Taxpayer will also provide blanket notification to purchasers by adding notification language to . Similarly, in the case of leased mx disposed of through the , Taxpayer will provide blanket notification to purchasers by adding notification language to the . The notifications contained in will be substantially to the effect that Taxpayer has assigned to QI all of Taxpayer’s rights (but not its obligations) arising under contracts entered into by Taxpayer with respect to the disposition of RQ.

In most cases, Taxpayer will also provide purchasers of RQ with transaction-specific notice of its assignment to the QI of Taxpayer’s rights (but not its obligations) under contracts entered into by Taxpayer with respect to the disposition of RQ. Each such notification will, in effect, be as follows:

> You are hereby notified that all of [Taxpayer’s] rights (but not its obligations) under the contract entered into by [Taxpayer] with respect to the disposition of the within-named [mx], have been assigned to the QI, acting as qualified intermediary, pursuant to the Master Exchange Agreement.

The manner in which such notice is delivered to a purchaser of RQ in or other

\(^2\) ACH is the Federal Reserve Automated Clearinghouse System. The Local Account is a City C local depository maintained by Bank A.
forms of disposition will depend on the disposition method. For mx sold, Taxpayer will. In situations arising from Taxpayer for specific mx, notification language will be included.

Taxpayer will provide with transaction specific notice at the inception of the LKE Program by adding notification language to prior to the inception of the program. Notification will be sent to program via . Taxpayer will also provide transaction-specific notice to who acquire leased mx pursuant to before the purchase.

Taxpayer will also provide transaction-specific notice to dd purchasers by adding the notice language to. In other instances where appropriate to , notice language will be added to to purchasers.

4. Assignment and Notification Procedures for RP.

As with RQ, Taxpayer will make a blanket assignment to the QI in the Master Exchange Agreement of Taxpayer’s rights (but not its obligations) under contracts entered into by Taxpayer with respect to the acquisition from Ee of RP. Under the Master Exchange Agreement, the assignment will become effective automatically for any RP prior to the acquisition of such RP. Taxpayer will provide the QI a list of RP to be acquired under purchase agreements assigned to the QI.

Taxpayer will also provide blanket notification to all Ee, before the inception of the LKE Program, by including in the Dd Bulletin additional language to the effect that Taxpayer has assigned to the QI all of Taxpayer’s rights (but not its obligations) under the contracts entered into by Taxpayer with respect to its acquisition of RP. New Ee will receive notification by means of language included in

In addition to the blanket notification, Taxpayer will also notify Ee from whom it acquires RP on a transaction-specific basis by means of notification language added to the for each leased mx purchased. The notice language will be to the following effect:

You are hereby notified that all of the rights of [Taxpayer] (but not its
obligations) under the contract entered into by [Taxpayer] with respect to its acquisition of the within referenced [mx] (if and at such time as such a contract arises) have been assigned to QI acting as qualified intermediary, pursuant to the Master Exchange Agreement.

5. LKE Program Cash Flow and Bank Account Structure.

The Master Exchange Agreement sets forth the bank account structure to be maintained by the QI and Taxpayer with respect to the LKE Program. Taxpayer already maintains the Local Account at Bank A and the Outflow Accounts at Bank B. In connection with the LKE Program, Taxpayer will establish a new joint QI/Taxpayer account at a third entity, which is an affiliate of the QI Administrator (or “Joint Concentration Account”). The Joint Concentration Account and the Local Account will constitute the “Inflow Accounts.” Taxpayer and the QI will enter into a separate agreement with each of the three different financial institutions (Bank A, Bank B and QI Administrator (which is a bank subsidiary)) with respect to each of the Inflow Accounts and the Outflow Accounts (collectively, the Joint Accounts), governing all funds received in respect of any leases or leased mx and with respect to funds held for the purchase of newly originated leases and related leased mx.

Under the LKE Program, all purchasers will be instructed to make checks payable to the QI, and to direct ACH or wire transfer payments to the Joint Local Account. With respect to disbursements under the LKE Program, the purchase price for a lease and the related leased mx, will be paid from the Outflow Accounts. If such mx constitutes RP, the purchase price will be paid from amounts held for the benefit of the QI (“QI Funds”). All other payments from the Outflow Accounts will be paid from amounts held for the benefit of Taxpayer (“[Taxpayer] funds”).

As funds are received in the Joint Accounts, they will be identified as QI Funds, Taxpayer Funds or Unidentified Funds. Unidentified Funds will be redesignated as QI Funds or Taxpayer Funds as they are identified.

Under each joint account agreement, all funds representing disposition proceeds of RQ (consisting of disposition proceeds less costs of sale and related expenses), and any other amounts designated as funds held for the benefit of the QI pursuant to the Master Exchange Agreement, including Taxpayer funds that are redesignated as QI Funds and investment earnings on funds on deposit in the Joint Accounts, shall be held for the benefit of the QI. All other funds, other than Unidentified Funds, will be held for the benefit of Taxpayer.

Under the terms of the Master Exchange Agreement and the joint account agreements, QI Funds may be applied only to purchase RP. QI Funds may not be used to purchase any other property or for any other purpose except where QI Funds are redesignated as
Taxpayer Funds pursuant to a Ff).

The Ff is used to monitor the transfer of collections and obtain Taxpayer’s and the QI’s authorization for disbursement funding. The report specifies how much is needed to fund purchases of RP, the amount of additional funds (if any) needed from Taxpayer for purchases of RP, and the amount of funds needed from Taxpayer for non-LKE disbursements. The report also states the total receipts received into the Joint Concentration Account, the amount of QI Funds, the amount of Unidentified Funds, the amount of Taxpayer funds, and the amount of non-like-kind exchange proceeds in the Joint Concentration Account that are to be transferred to the ACH loan account or to a Taxpayer account. Representatives of both the QI and Taxpayer must authorize transfers before they occur. As provided in the Master Exchange Agreement, no funds can move out of the Outflow Accounts without the QI’s authorization.

Funds in the Joint Local Account will be __________ into the Joint Concentration Account ______. Under the Master Exchange Agreement and each joint account agreement, funds may be moved out of the Joint Concentration Account to an Outflow Account, an account controlled by Taxpayer, or to a collection account or other account relating to a Taxpayer financing arrangement only with the joint approval of the QI and Taxpayer. To obtain approval, Taxpayer will send to the QI a Ff each day. Taxpayer will provide its authorization by having a Taxpayer representative sign the report. The QI will review the report and provide authorization by having a QI representative sign the report and provide it to the bank, thereby allowing funds to move.

All funds held in the Joint Accounts at the end of each day will be invested in accordance with Taxpayer’s instructions. Any income earned on these funds will be reported by Taxpayer for tax purposes. The earnings on all funds will be designated as QI Funds held for the benefit of the QI and, like LKE disposition proceeds, may be used solely to acquire RP in the future.

All funds constituting LKE disposition proceeds will be held for the benefit of the QI. Taxpayer will act as the servicer under the LKE Program to open envelopes and process and deposit checks into the Joint Local Account. Taxpayer begins the process of sorting and identifying LKE disposition proceeds and non-LKE disposition proceeds as payments are posted to Taxpayer’s information system.

Disbursements for the acquisition of all leases and the related leased mx (without regard to whether the leased mx are RP) and for acquisition of __________ will be made through the Outflow Accounts. Thus, the Outflow Accounts will continue to serve as a cash clearinghouse for all such disbursements by Taxpayer, enabling Taxpayer to issue a single payment to an Ee for all of Taxpayer’s acquisitions from that Ee. To the extent the amount of QI funds in the Joint Accounts is insufficient to fund the acquisition of RP, Taxpayer will make up any shortfall.
Certain transactions involving RQ and/or RP require adjustments to the amounts in the QI funds and Taxpayer funds held in the Joint Accounts. Each of these transactions and the necessary adjustments are discussed below in further detail.

A. Application of Lease Security Deposit to Purchases. Under the agreements pursuant to which Taxpayer acts as servicer for the , Taxpayer holds lessee security deposits, to be applied upon lessee default or termination of the lease. If a lessee decides to purchase a leased mx, at or prior to the expiration of the lease term, the lessee can instruct Taxpayer to apply all or part of the remaining security deposit (after application against lease termination charges) against the purchase price of the leased mx. This is possible for .

In the case of a leased mx constituting RQ, the lease security deposit applied by Taxpayer against the purchase price constitutes a part of the LKE disposition proceeds for such RQ. As a result, Taxpayer and the QI will be required under the Master Exchange Agreement and the joint account agreement to notify the bank of such adjustment in the Ff. The amount of Taxpayer funds in the Joint Accounts will be reduced and the amount of QI Funds in the Joint Accounts will be increased by the amount of the lease security deposit so applied.

B. Application of Lease Security Deposit to Taxpayer Purchase from Dd. In the case of a newly originated leased mx, an Ee may receive a security deposit from the lessee. When Taxpayer purchases a leased mx from an Ee, Taxpayer funds the purchase net of the security deposit and assumes the obligation to repay the security deposit upon the termination of the lease.

Where the security deposit received by the Ee is applied against the purchase price of a leased mx that constitutes RP, the security deposit is part of the purchase price obligation the QI owes the Ee. In order for the QI to expend the full amount of the purchase price for RP under the Master Exchange Agreement, QI funds in an equal amount to the security deposit will be redesignated as Taxpayer funds by means of the Ff.

C. Transactions. In the normal course of its business, Taxpayer provides financing to . In such transactions, Taxpayer obtains the purchaser’s note in a separate transaction from the disposition of the leased mx. In the case of a leased mx constituting RQ, either Taxpayer will forward to the QI the financed amount representing the LKE disposition proceeds, or an adjustment will be made in the Ff redesignating Taxpayer funds in the financed amount as the QI funds.
D. Taxpayer-Financed Dd Purchases. Taxpayer also provides financing to dd under its wx financing program. Under this program, dd may finance purchases as well as purchases through other disposition channels. In the case of actual cash transfers are made with respect to the disposition proceeds and amounts financed. Under the LKE Program, the disposition proceeds will be made payable to the QI, while the amounts financed will be separately transferred by Taxpayer. Therefore, no adjustments will be necessary when dd finance purchases under Taxpayer’s wx financing program.

Where Taxpayer finances dd purchases in other disposition channels (i.e., , etc.), no actual cash transfers occur. Instead, a dd makes a from Taxpayer by making a draw under its wx financing arrangement with Taxpayer and Taxpayer sets up a receivable with respect to the transaction. In the case of a purchase of a leased mx constituting RQ, either Taxpayer will forward to the QI the financed amount representing LKE disposition proceeds, or an adjustment will be made in the Ff redesignating Taxpayer funds in the financed amount as the QI funds.

Alternatively, in some instances, LKE disposition proceeds will actually flow from the dd to the Joint Local Account, and the amount financed will be separately transferred from Taxpayer to the dd. This occurs in two separate transactions: First, the dd pays off the mx by check or ACH transfer, and second, Taxpayer separately transfers the financed amount to the dd, typically by ACH. In such a transaction, a dd that participates in Taxpayer’s wx financing program purchases RQ by adding the mx to its wx arrangement.

E.


All disbursements and collections relating to leases and the related leased mx, including leased mx that are not RQ or RP in an LKE transaction, will flow through the Inflow and Outflow Accounts. However, pursuant to the Master Exchange Agreement and each joint account agreement, non-LKE disbursements will be funded solely from Taxpayer funds.
7. Legal Agreements Governing Cash Flows.

The Master Exchange Agreement and the joint account agreements provide that Taxpayer has no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held as Unidentified Funds at any time or as QI Funds with respect to any exchange, before the occurrence of a circumstance listed in §1.1031(k)-1(g)(6).

8. Matching.

As part of the LKE transaction, LKE disposition proceeds will flow through the LKE account structure and be used to acquire RP. Information about RQ and RP will be analyzed by a computer algorithm to match RQ with RP for which it was exchanged according to certain parameters designed primarily to maximize the benefits of the LKE Program. For example, RQ will be matched only with RP acquired within 45 days of the date RQ was transferred to its purchaser and, to the extent possible, RQ will be matched with RP costing at least as much as the RQ.

In the LKE transactions that will occur under this system, Taxpayer proposes to classify exchange property consisting of Category A, Category B, and Category C as belonging to Class1 and exchange property consisting of Category B, and Category C, and Category D as belonging to Class2. RQ in Class1 will be matched only with RP in Class1 and RQ in Class2 will be matched only with RP in Class2.

APPLICATION OF LAW TO FACTS:

Section 1031(a)(1) provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment. Thus, for a transaction to qualify as an exchange under §1031, the exchanged properties must be of a like kind and held for productive use in a trade or business or for investment.

Ruling Request Number 1:

Taxpayer requests a ruling that properties described as being within Category A, Category B and Category C (which Taxpayer groups into Class1) are of like kind and properties described as being within Category B, Category C and Category D (which Taxpayer groups into Class2) are of like kind.

The requirement that the exchanged properties be of like kind has reference to the nature or character of the property and not to its grade or quality. Section 1.1031(a)-1(b). To qualify for like-kind exchange treatment, one kind or class of property may not
be exchanged for property of a different kind or class. Depreciable tangible personal properties are of a like class if they are either within the same General Asset Class, as defined in §1.1031(a)-2(b)(2), or within the same Product Class, as defined in §1.1031(a)-2(b)(3). If a property is classified within any General Asset Class, it may not be classified within a Product Class. Section 1.1031(a)-2(b)(1).

Section 1.1031(a)-2(b)(2) describes the various General Asset Classes. The regulations specifically provide that property in Category A is within Class1 and property in Category D is within Class2. The regulations do not specify Category B or Category C property as belonging to either Class1 or Class2. See also Rev. Proc. 87-56, 1987-2 C.B. 674. However, §1.1031(a)-2(b)(3), as updated pursuant to §1.1031(a)-2(b)(4) and (5), provides for matching of property belonging to the same product class as specified under the classification code of the Standard Industrial Classification Manual (1987) ("SIC Manual"), now currently updated under the North American Industry Classification System (1997) ("NAICS Manual").

To the extent that each exchange consists of one or more RQ and one or more RP in the same General Asset Class or the same Product Class, these exchanges fit within the General Asset Class or the Product Class safe harbor described above. The General Asset Class and Product Class safe harbors in the regulations simplify the determination of whether depreciable tangible personal property is of a like kind. Under the Product Class safe harbor, according to Subsector xx of the NAICS Manual, property within Categories B, C and D are all of the same product class.

However, the General Asset Class and Product Class safe harbors are not the exclusive method for determining if exchange properties are of like-kind. For depreciable tangible personal property to be considered of like kind for purposes of §1031, the property can be either like kind or like class. Section 1.1031(a)-2(a) provides that "an exchange of properties of a like kind may qualify under §1031 regardless of whether the properties are also of like class. In determining whether exchanged properties are of a like kind, no inference is to be drawn from the fact that the properties are not of a like class." Thus, two properties can be in different General Asset Classes (and thus not be of a like class) and yet be of like kind.

The like-kind standard has been interpreted more narrowly in the case of exchanges of personal property as compared to exchanges of real property. See California Federal Life Insurance Co. v. Commissioner, 680 F.2d 85, 87 (9th Cir. 1982) (Tax Court did not err in refusing to apply the lenient treatment of real estate exchanges to an exchange of personal property involving U.S. Double Eagle $20 gold coins and Swiss francs). Even within the more restrictive parameters of the like-kind standard as applied to personal property, the differences between property in Category A, Category B and Category C
do not rise to the level of a difference in nature or character but are merely a difference in grade or quality.

Therefore, properties described as belonging to Categories A, B and C are of like-kind even if they do not belong to the same general asset class. Also, properties in Categories B, C and D are of like kind or like class because they are within the same Product Class.

Ruling Request No. 2:

Taxpayer requests a ruling that its transfer of each RQ, or group of RQ, and the corresponding receipt of RP, or group of RP, in accordance with the Master Exchange Agreement will be treated as a separate and distinct exchange for purposes of §1031. Taxpayers are allowed great latitude in structuring transactions under §1031. Biggs v. Commissioner, 69 T.C. 905, 913 (1978). Moreover, the regulations governing exchanges of multiple properties require such groupings when taxpayers exchange multiple properties. For example, §1.1031(j)-1(a)(2)(i) generally provides that the amount of gain recognized in an exchange of multiple properties is computed by first separating the properties transferred and the properties received by the taxpayer in the exchange into exchange groups.

If an exchanger is complying with all requirements under the Code and regulations for exchanging property under §1031, any reasonable arrangement of like-kind properties into exchange groups as relinquished or replacement property for separate transactions, consistent with the regulations, should be respected. In the case of an LKE Program, a taxpayer’s transfer of each RQ, or group of RQ, and the taxpayer’s corresponding receipt of each RP, or group of RP, with which such RQ, or group of RQ, has been matched by the taxpayer is treated as a separate and distinct exchange for purposes of §1031. The determination of whether a particular exchange qualifies under §1031 will be made without regard to any other exchange. Thus, if a particular exchange of RQ, or group of RQ, for an RP, or group of RP, pursuant to an LKE Program fails to qualify under §1031, such failure will not affect the application of §1031 to any other exchange pursuant to such LKE Program.

Therefore, Taxpayer’s transfer of each RQ, or group of RQ, and the corresponding receipt of RP, or group of RP, in accordance with the Master Exchange Agreement will be treated as a separate and distinct exchange for purposes of §1031.

Ruling Request No. 3:
Taxpayer requests a ruling that each exchange, in accordance with the Master Exchange Agreement, of one or more RQ for one or more RP will qualify for nonrecognition of gain or loss provided no money or other non-like-kind property is received by Taxpayer. If Taxpayer does receive money or other non-like-kind property in an exchange, gain with respect to RQ transferred will be recognized in an amount not in excess of the sum of such money and the fair market value of such other non-like-kind property.

Section 1031(b) provides that if an exchange would be within the provisions of §1031(a) if it were not for the fact that the property received in the exchange consists not only of property permitted by such section to be received without recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1.1031(k)-1(f)(1) generally provides that a transfer of relinquished property in a deferred exchange is not within the provisions of §1031(a) if, as part of the consideration, the taxpayer receives money or other property. However, such a transfer, if otherwise qualified, will be within the provisions of either §1031 (b) or (c). 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. 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, in part, that except as provided in §1.1031(k)-1(g) (relating to safe harbors), for purposes of §1031 and §1.1031(k)-1, 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 taxpayer's method of accounting. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to §1.1031(k)-1(k)) is actual or constructive receipt by the taxpayer.

Section 1.1031(k)-1(g)(2) through (g)(5) sets forth a variety of safe harbors for use in deferred exchange situations. The use of one or more of these safe harbors in a deferred exchange will shield a taxpayer from actual or constructive receipt of money or other property. In the present case, Taxpayer will use the qualified intermediary safe harbor as described in §1.1031(k)-1(g)(4). Section 1.1031(k)-1(g)(4)(i) 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 §1031(a). In such a transaction, 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.

Section 1.1031(k)-1(g)(4)(ii) states that the qualified intermediary safe harbor applies only 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 §1.1031(k)-1(g)(6).

In the present case, Taxpayer is entering into a Master Exchange Agreement with an accommodator represented to meet all the prerequisites to be a qualified intermediary. Taxpayer further represents that the agreement contains all restrictions necessary to qualify the planned deferred exchanges as tax deferred exchanges under §1.1031(k)-1.

Therefore, each exchange in accordance with the Master Exchange Agreement of one or more RQ transferred for one or more RP will qualify for nonrecognition of gain or loss provided no money or other non-like-kind property is received by Taxpayer. If Taxpayer receives money or other non-like-kind property in an exchange, gain with respect to RQ transferred will be recognized in an amount not in excess of the sum of such money and the fair market value of such other non-like-kind property.

Ruling Request No. 4:

Taxpayer requests a ruling that QI, acting in accordance with the Master Exchange Agreement, be treated as a qualified intermediary as defined in §1.1031(k)-1(g)(4) and be treated as acquiring and transferring each RQ and each RP for purposes of §1031.

Section 1.1031(k)-1(g)(4)(iii) defines the term “qualified intermediary” as a person, not the taxpayer or a disqualified person (as defined in §1.1031(k)-1(k)), who enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers
the replacement property to the taxpayer.\textsuperscript{3}

Regardless of whether an intermediary acquires and transfers property under general tax principles, an intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property to that person, and pursuant to that agreement, the relinquished property is transferred to that person. See §1.1031(k)-1(g)(4)(iv)(B). An intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer. Section 1.1031(k)-1(g)(4)(iv)(C). For these purposes, an intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the relevant transfer of property. See §1.1031(k)-1(g)(4)(v).

In the instant case, Taxpayer has assigned to QI its rights to sell RQ. In all instances, the purchaser receives notice of the assignment prior to the time that the RQ is transferred to the purchaser. Each form of notice informs the purchaser in writing that Taxpayer has assigned to QI its rights to sell RQ. Title to RQ will be transferred directly from Taxpayer to the purchaser of RQ pursuant to the agreement between Taxpayer and purchaser. Thus, QI will be treated as acquiring and transferring RQ. See §1.1031(k)-1(g)(4)(iv)(B) and (v).

\textsuperscript{3} Section 1.1031(k)-1(k)(1) of the regulations defines the term “disqualified person” as a person described in §1.1031(k)-1(k)(2), (k)(3), or (k)(4). Essentially, a disqualified person is an agent of the taxpayer, or a person related to the taxpayer or the agent. Generally, 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. However, for purposes of this definition, performance of the following services are not 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.
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In addition, Taxpayer assigned its right to purchase RP to QI. In all instances, the seller receives notice prior to the transfer of RP to Taxpayer. Each form of notice informs the seller in writing that Taxpayer has assigned to QI its rights to purchase RP. RP is transferred directly to Taxpayer pursuant to the agreement between seller and Taxpayer. Thus, QI will be treated as acquiring and transferring RP. See §1.1031(k)-1(g)(4)(iv)(C) and (v).

Accordingly, QI, acting in accordance with the Agreement, and if otherwise qualified, will be treated as a qualified intermediary as defined in §1.1031(k)-1(g)(4)(iii) and will be treated as acquiring and transferring each RQ and each RP for purposes of §1031.

Ruling Request No. 5:

Taxpayer requests a ruling that Taxpayer will not be in actual or constructive receipt of money or other property from the disposition of RQ transferred in accordance with the Master Exchange Agreement (including any money or other property held in the Joint Accounts) unless and until such money or other property is actually transferred directly to Taxpayer or to an account solely in the name of Taxpayer.

Proceeds from the sale of RQ are deposited into a joint bank account belonging to Taxpayer and QI (the Joint Accounts). Similarly, Taxpayer's agreements provide that amounts collected from are deposited into accounts specified by the QI and Taxpayer (the Joint Accounts). Taxpayer is not in actual or constructive receipt of proceeds of sales of RQ that are deposited in the Joint Accounts, and ultimately used to acquire RP. The Master Exchange Agreement and the joint account agreements also provide that no funds can be withdrawn without QI approval. These agreements restrict, as required by §1.1031(k)-1(g)(4)(ii) and (g)(6)(i), Taxpayer's right to receive, pledge, borrow or otherwise obtain the benefits of RQ proceeds and earnings thereon, that are held in the Joint Accounts until the expiration of the periods described. The

4 Section 1.1031(k)-1(g)(6)(i) generally provides that an agreement limits a taxpayer's rights 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, except as provided in §1.1031(k)-1(g)(6)(ii) and (g)(6)(iii). Section 1.1031(k)-1(g)(6)(ii) provides that the agreement may provide that if the taxpayer has not identified replacement property by the end of the identification period, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property at any time after the end of the identification period. Section 1.1031(k)-1(g)(6)(iii) provides that the agreement may provide that if the taxpayer has identified replacement property, the taxpayer may have rights to receive,
Master Exchange Agreement and joint account agreements provide that QI has first priority to those funds in the Joint Accounts which are the full amount of proceeds from sales of RQ. To the extent that funds from the sale of RQ are insufficient to cover the purchase of RP, Taxpayer transfers funds to cover the amount of the purchases.

Therefore, Taxpayer will not be in actual or constructive receipt of money or other property from the disposition of RQ transferred in accordance with the Master Exchange Agreement (including any money or other property held in the Joint Accounts) unless and until Taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in the Joint Accounts mature as provided in the Master Exchange Agreement.5

Ruling Request No. 6:

Taxpayer requests a ruling that Taxpayer's participation in accordance with the Master Exchange Agreement in identifying sales proceeds from the disposition of RQ and in sorting those proceeds from other funds (including processing, depositing, and other handling of checks representing proceeds from disposition of RQ) does not result in actual or constructive receipt of money or other property from the disposition of RQ.

pledge, borrow, or otherwise obtain the benefits of money or other property upon or after –

A. The receipt by the taxpayer of all of the replacement property to which the taxpayer is entitled under the exchange agreement; or

B. The occurrence after the end of the identification period of a material and substantial contingency that – (1) relates to the deferred exchange, (2) is provided for in writing, and (3) is beyond the control of the taxpayer and of any disqualified person other than the person obligated to transfer the replacement property to the taxpayer.

5 We here note specifically that constructive receipt of proceeds from RQ may occur prior to actual transfer of funds to Taxpayer's possession from the Joint Account. Section 1.451-2(a) of the regulations provides, in part, that income although not actually reduced to a taxpayer's possession is constructively received by the taxpayer in the taxable year during which it is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. See also §1.1031(k)-1(f)(2) applying the doctrine of constructive receipt to all taxpayers engaging in like-kind exchanges under the deferred exchange regulations (§1.1031(k)-1), irrespective of the method of accounting otherwise employed by the taxpayer.
Section 1.1031(k)-1(f)(2) provides, in part, that a taxpayer is in actual receipt at the time the taxpayer actually receives money or property or receives the economic benefit of the money or property. It also provides that a taxpayer is not in constructive receipt if the taxpayer’s control over the money or property is subject to substantial limitations or restrictions, but is in constructive receipt at the time the limitations or restrictions lapse, expire, or are waived. Thus, a taxpayer is considered to have constructive receipt if the money or property is credited to the taxpayer’s account, set apart for the taxpayer or otherwise made available so that the taxpayer may draw on it at any time or when notice of intention to draw upon it is given.

An important function performed by taxpayers in the leasing business is the day to day processing of leases and other payments called for under the lease agreements. In its capacity as a “servicer,” Taxpayer opens envelopes from lessees, deposits checks, and records payments to lessees’ accounts. Taxpayer may also process numerous other kinds of payments related to its leasing business (e.g., , etc.). In addition, Taxpayer may also process payments in connection with other lines of business in which Taxpayer is engaged. Business realities may require that all payments be sent to one or more central locations for processing and sorting.

In the course of its operations, Taxpayer will receive for RQ. These checks, which are payable to the QI, but delivered to Taxpayer, are deposited by Taxpayer into Local Account (one of the Joint Accounts of Taxpayer and QI) after Taxpayer performs bookkeeping and recording tasks with respect to payments which constitute LKE disposition proceeds.

Taxpayer will have assigned to QI its rights to the disposition proceeds under the contracts for the sale of RQ. Prior to the sale of any RQ, purchasers will have been notified to make all checks payable to QI. Taxpayer’s receipt and handling as servicer of checks made payable to another party do not constitute actual or constructive receipt of such checks, because Taxpayer has no right to negotiate the check or deposit it (or any other form of payment) into a separate account of Taxpayer. See UCC §§3-110 and 3-420 (respectively pertaining to the negotiation and conversion of negotiable instruments).

Therefore, Taxpayer’s participation in accordance with the Master Exchange Agreement in identifying sales proceeds from the disposition of RQ and in sorting those proceeds from other funds (including processing, depositing, and other handling of checks representing proceeds from disposition of RQ) does not result in actual or constructive receipt of money or other property from the disposition of RQ.

Ruling Request No. 7:
Taxpayer requests a ruling that for the purchases of RQ financed by Taxpayer (either as a separate note, a receivable, or as part of a dd wx), Taxpayer’s receipt of the borrower’s note or other evidence of indebtedness does not constitute actual or constructive receipt of money or other property from the disposition of RQ.

In the ordinary course of its business, Taxpayer provides financing to dd and individuals. Dd and other purchasers of Taxpayer’s leased mx are under no obligation to finance purchases with Taxpayer and are free to obtain financing from other financial institutions. Taxpayer’s provision of financing to dd and the application of a lessee’s lease security deposit constitute separate and distinct arm’s length transactions from the lessee’s purchase of a mx. When Taxpayer receives a note evidencing an amount that it is financing, Taxpayer records the note in a wholly separate transaction from that in which the amount financed is recorded. Similarly, Taxpayer’s provision of wx financing to dd is recorded in a wholly separate transaction from the disposition of the leased mx.

A taxpayer may advance money toward the purchase of property to be acquired by exchange. See 124 Front Street v. Commissioner, 65 T.C. 6 (1975); Biggs v. Commissioner, 632 F.2d 1171 (5th Cir. 1980), aff’g 69 T.C.905 (1978). In an installment sale situation the term “payment” generally does not include the receipt of an evidence of indebtedness from the person acquiring the property. Section 15a.453-1(b)(3)(i).

Accordingly, if Taxpayer’s programs for financing purchases of its RQ (either on a separate note, a receivable, or as part of a dd wx) are at arm’s length, with market rates and terms, and if Taxpayer promptly transfers funds equal to the loan proceeds to or for the benefit of QI, Taxpayer’s receipt of the borrower’s note or other evidence of indebtedness does not constitute actual or constructive receipt of money or other property from the disposition of RQ.

Ruling Request No. 8:

Taxpayer requests a ruling that, for RQ purchased by the lessee of RQ, Taxpayer’s application of the lessee’s lease security deposit against the purchase price of RQ does not constitute actual or constructive receipt of money or other property from the disposition of RQ.

When Taxpayer sells a leased mx to a lessee, Taxpayer will apply all or part of the lessee’s remaining lease security deposit (after application against lease termination charges) against the lessee’s purchase price of the leased mx at the direction of the lessee. If the lessee does not direct Taxpayer to apply the remaining security deposit against the lessee’s purchase price obligation, Taxpayer must return the security deposit to the lessee under the terms of the lease. If the lessee requests that its security deposit be applied against the purchase price of a leased mx that constitutes
RQ, an amount of Taxpayer funds equal to the applied security deposit will be redesignated as QI funds in the Ff, so that QI receives the full amount of LKE disposition proceeds.

When Taxpayer purchases a leased mx from an Ee, the Ee may apply the security deposit received from the lessee against Taxpayer’s purchase price obligation owed to the Ee. If the Ee applies the lessee’s security deposit against the purchase price of a leased mx that constitutes RP, QI funds in an amount equal to the applied security deposit will be redesignated as Taxpayer funds in the Ff. The application of the security deposit against the purchase price obligation is merely for administrative convenience to the Ee. By redesignating QI funds as Taxpayer funds, in an amount equal to the security deposit, QI is simply expending the full purchase price for RP.

Rev. Rul. 72-519, 1972-2 C.B. 32, 33, states that in cases involving rental property, payments received by a lessor to secure the lessee’s performance of covenants contained in a lease, and which are to be refunded at the expiration of the lease are not taxable income even though the lessor had use of the money. According to the revenue ruling, even if the parties may apply the security deposit against the purchase price of the rented property, the deposit will not be treated as a taxable advance payment if its primary purpose is to protect the lessor’s title and interest and to guarantee faithful performance of the lease agreement. Under Commissioner v. Indianapolis Power & Light Co., 493 U.S. 203 (1990), a taxpayer lessor does not take the lessee’s security deposit into income as long as its control and dominion over the deposit is incomplete and subject to conditions outside the control of the taxpayer. To the extent deposit funds are available to lessee as partial payment of the purchase price, they are funds belonging to the lessee.

Therefore, with respect to RQ that is purchased by the lessee, Taxpayer’s application of the lessee’s lease security deposit against the purchase price of RQ does not constitute actual or constructive receipt of money or other property from the disposition of RQ, provided that such applications of security deposits occur promptly and are in accordance with either the lessee’s specific instructions or with the terms of the sales agreement between Taxpayer and lessee.

CAVEATS AND EXCEPTIONS:

Except as specifically provided above, no opinion is expressed as to the federal income tax treatment of the LKE Program and the transactions described under any other provisions of the Internal Revenue Code and the Income Tax Regulations that may be applicable or under any other general principles of federal income tax law. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, nor effects resulting from, the transactions that are not specifically covered by the above ruling. Finally, no opinion is expressed regarding whether the accommodators used in
the LKE Program or the transactions described are disqualified persons, as defined in §1.1031(k)-1(k), because such determinations are factual. This ruling assumes that the QI and the QI Administrator are eligible under the regulations to serve as qualified intermediaries.

This ruling is directed only to the taxpayer(s) who requested it. Section 6110(k)(3) of the Code provides that it may not be cited as precedent. Pursuant to a Power of Attorney submitted by Taxpayer, a copy of this letter will be sent to Taxpayer's authorized representatives.

Sincerely yours,
Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: