Internal Revenue Service

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Department of the Treasury

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CC:DOM:P&SI:5 - PLR-110941-99
Date: 10/20/99

LEGEND:

Taxpayer =

Corp 1 =

State =

City =

b =

c =

d =

f =

g =

h =

p =

r =

Dear :

This letter responds to Taxpayer's letter dated b, and subsequent correspondence, requesting private letter rulings concerning the qualification of the Master Lease Agreement and Lease Order under § 7701(h) of the Internal Revenue Code.

The relevant facts as represented in Taxpayer's submission are set forth below.

Taxpayer is a closely held State corporation, which is the common parent of an

affiliated group of corporations filing a consolidated return under §§ 1502 and 1504. Taxpayer's federal income tax returns are under the audit jurisdiction of the District Director, City. Taxpayer's federal income tax return is filed on the basis of a c fiscal year.

Corp 1, the principal operating subsidiary of Taxpayer, is engaged in the . Corp 1 has a in excess of d . It's customers lease from f to more than g . The vast majority of the clients of Corp 1 have high-quality credit thereby diminishing the chance of credit losses. Historically, rental defaults by the clients of Corp 1 rarely have occurred. For each client there is a Master Lease Agreement, and when a new is added to the lease, there is a "Lease Order."

Corp 1 provides the following services, among others, to its clients:

Corp 1 has an initial capital investment in the , but also finances a substantial portion of its costs. The borrowed funds are provided by a consortium of banks and other financing sources on a full recourse basis. Security for the debt is also provided in the form of a pledge of and rentals payable under the leases. The majority of Corp 1's leases are commonly referred to as . In an , a lessor will receive a payment from the lessee at the termination of the lease if the disposition proceeds are lower than expected, and will pay an amount to the lessee if a portion of the disposition proceeds are higher than expected. This rental adjustment feature is referred to as a).

Corp 1 will form a special purpose limited liability company (LLC). Corp 1 will own all the membership interests of LLC. Pursuant to the terms of the membership agreement, LLC will have a management committee of not less than p or more than r members that at all times will include at least 1 independent manager.

LLC will be capitalized with $h. This amount will be LLCs minimum capital, and this minimum capital amount will exist at the inception of every new transaction. No distribution of the capital to Corp 1 (or any other member of Taxpayer's affiliated group) will be made by LLC except upon liquidation of LLC. To the extent that such minimum capital is reduced to an amount less than $h, LLC's minimum capital must be restored by additional capital contributions by Corp 1 prior to the consummation of a new transaction. No third party rights to force additional capital contributions are created. In addition to its minimum capital, LLC will have additional capital supplied by Corp 1 in the form of "overcollateralization" (described below). No election has been or will be filed under § 301.7701-3(c) of the Procedure and Administrative Regulations for LLC to

be treated as an association.

In the proposed transaction, Corp 1 will assign all of its rights, title, and interest in certain and their associated leases and rental streams to LLC. Corp 1 will retain bare legal title to the . Corp 1 will be obligated to turn over to LLC all net proceeds of disposition of the , and Corp 1 will pledge legal title to secure that obligation. LLC will pay for the assigned rights with funds borrowed from the lenders in the proposed transaction. Corp 1 will continue to provide all necessary lease services to Corp 1's customers.

Under the terms of the proposed transfer from Corp 1 to LLC, Corp 1 will collect all amounts payable under a lease and all net disposition proceeds. LLC will be entitled to receive all amounts collected by Corp 1 except for an amount retained by Corp 1 as its servicing fee. If disposition proceeds are such that the lessee is entitled to receive a payment, the obligation to make the payment will be satisfied out of amounts belonging to LCC. The service fee amount retained by Corp 1 will be equal to the dollar amount per month, per . Taxpayer represents that assuming rental defaults are consistent with historical experience, LCC should receive amounts sufficient to make any necessary payment to a lessee, satisfy its obligations to its lenders, and make a profit. The profit may be distributed to Corp 1, consistent with maintenance of the $h minimum capital requirement.

Taxpayer further represents that LCC incurs a fully recourse obligation to its lenders, and LCC's creditors have full recourse against all of the assets of LCC, which include its contributed capital and capital in the form of overcollateralization in each transaction. Overcollateralization in one such transaction is available to creditors in another transaction. On a per- basis, Corp 1 assigns the rights to LCC for an amount equal to the invoice cost of a , reduced by the "reserve payments" for the that have already been made by the lessee as of the time of the transfer. The total amount payable by LCC to Corp 1 is determined in the aggregate and not on a , and it is a percentage of the total amount that would be determined on a . Corp 1 transfers (and leases and associated rental streams) with a net value of slightly greater than the payment made by LLC. The amount of overcollateralization is expected to be equal to approximately r percent of the amount borrowed by LCC in each securitization transaction.

Rental defaults on Corp 1's leases are unusual. Historically, such defaults have been less than 1/100 of 1 percent of the rentals due under the leases. Consequently, Taxpayer represents that LLC's assets, as reflected in its rental stream, its minimum capital, and its overcollateralization asset, should at all times protect the lenders. Further, Taxpayer represents that LLC's liability is a fully recourse obligation.

As payments are made under the transaction, the amount of overcollateralization

will be reduced proportionately, and the excess amounts may be distributed by LLC to Corp 1. In addition, when the book value of leased reaches a certain level, which generally is 10 percent of the initial book value, LCC has the option to pay the remainder of its obligation and obtain a release of the remaining . Funds to make this prepayment may come from the proceeds of overcollateralization, or may be advanced by Corp 1. It is contemplated that the remaining rental stream, for such remaining would be transferred to Corp 1.

Taxpayer requests rulings that 1) the Master Lease Agreement and Lease Order are qualified motor vehicle operating agreements under § 7701(h)(2); 2) qualification of the Master Lease Agreement and the Lease Order as leases, for federal income tax purposes, in the hands of Corp 1 and LLC, will be determined without regard to the provision of the Master Lease Agreement; and 3) Under § 301.7701-3(b), no gain, loss, or income will be realized by Corp 1 or LCC as a result of the transfer of a vehicle from Corp 1 to LCC as part of the transaction described above.

Section 7701(h)(1) provides that in the case of a qualified motor vehicle operating agreement that contains a terminal rental adjustment clause, the agreement is treated as a lease if (but for such terminal rental adjustment clause) the agreement would be treated as a lease for federal income tax purposes, and the lessee is not treated as the owner of the property subject to the agreement during the period the agreement is in effect.

Section 7701(h)(2) defines a qualified motor vehicle operating agreement as any agreement with respect to a motor vehicle (including a trailer) that meets the following requirements. First, under the agreement, the sum of the amount the lessor is personally liable to repay, and the net fair market value of the lessor's interest in any property pledged as security for property subject to the agreement, must equal or exceed all amounts borrowed to finance the acquisition of property subject to the agreement. Any property pledged that is property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement is not taken into account. Second, the agreement must contain a separate written statement signed by the lessee that the lessee certifies, under penalty of perjury, that it intends that more than 50 percent of the use of the property subject to the agreement is to be in a trade or business of the lessee, and that clearly and legibly states that the lessee has been advised that it would not be treated as the owner of the property subject to the agreement for federal income tax purposes. Finally, the lessor must not know that the certification is false.

Section 301.7701-3(b)(1)(ii) provides that a domestic eligible entity (a business organization not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) with a single owner is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to be treated as a corporation. If the entity

is disregarded, its activities are treated in the same manner as those of a division of its owner, and its assets will be treated as those of the owner.

The facts, representations, and documents provided by Taxpayer indicate that the Master Lease Agreement and Lease Order will meet the definition of a "qualified motor vehicle operating agreement" under § 7701(h)(2). The representations provided by Taxpayer further indicate that no election has been or will be filed under § 301.7701-3(c) of the Procedure and Administrative Regulations for LLC to be treated as an association.

Accordingly, based on the foregoing facts, representations, and law, we rule as follows:

1) the Master Lease Agreement and Lease Order are qualified motor vehicle operating agreements under § 7701(h)(2);

2) qualification of the Master Lease Agreement and the Lease Order as leases, for federal income tax purposes, in the hands of Corp 1 and LLC, will be determined without regard to the provision of the Master Lease Agreement; and

3) No income, gain, or loss will be realized by Corp 1 or LLC as a result of the transfer of property from Corp 1 to LLC.

Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations. Specifically, no opinion is expressed concerning whether or not the Master Lease Agreement and Lease Order are true leases for federal income tax purposes. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Walter H. Woo
Senior Technician Reviewer, Branch 5
Office of the Assistant, Chief Counsel
(Passthroughs and Special Industries)

Enclosures:
Copy for 6110(k)(3) purposes
Copy for filing purposes