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The Honorable Michael F. Mundaca
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United States Treasury Department
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Robert Crnkovich
Senior Counsel
United States Treasury Department
1500 Pennsylvania Avenue, N.W.
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The Honorable Jeffrey Van Hove
Acting Tax Legislative Counsel
United States Treasury Department
1500 Pennsylvania Avenue, N.W.
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The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
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Washington, D.C. 20224

Request for Clarifying Guidance Under Section 7701(o)

Dear Sirs,

On behalf of the Equipment Leasing and Finance Association (ELFA), we are writing in response to the issuance of Notice 2010-62, which provides interim guidance regarding the recent codification in Section 7701(o)¹ of the economic substance doctrine (“Notice”). In our prior submission on this subject we urged the Treasury Department to issue targeted guidance that confirmed the ongoing application of Internal Revenue Service (“IRS”) leasing guidelines on profit and cashflow and a limited number of common sense market practices to investments in

¹ Section references are to the Internal Revenue Code of 1986, as amended.

property entitled to one or more Congressionally approved investment tax incentives² (“Investment Tax Incentives”).

As discussed below, the issuance of the Notice has not provided our members with the clarifying guidance needed for the conduct of their businesses, but has actually created greater uncertainty concerning the application of Section 7701(o). We again urge the Treasury Department to issue targeted guidance concerning investments in assets entitled to Investment Tax Incentives.

The Notice

The Notice provides limited guidance of a very general nature, including general references to pre-codification authorities, without any specific references that might help guide taxpayers. Further, the Notice indicates an expectation that the case law will continue to develop in this area. The Notice does not clarify or even refer to any of the circumstances or transactions that the Joint Tax Committee’s Technical Explanation of Section 7701(o)³ indicates that Congress intended to exclude from the application of Section 7701(o). The Notice does not provide any guidance as to leasing transactions or tax credit transactions. By its various omissions and its suggestion of future litigation, the Notice creates more uncertainty than it resolves.

The Joint Tax Committee Explanation states that Section 7701(o) is not intended to disallow tax benefits “[i]f the realization of the tax benefits of a transaction is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate ...”⁴.

² Congressionally approved investment tax incentives are tax incentives or benefits enacted to encourage investment in various categories of property and activities. Examples include accelerated depreciation, bonus depreciation, current deductions (e.g. film production), production tax credits, investment tax credits, cash grants and subsidies.

³ J. Comm. On Taxation, 111th Cong., *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act,”* at 152-151 (Comm. Print 2010).

⁴ *Id.* at 152, fn 344.

The Joint Committee Explanation provides examples⁵ of the kinds of tax benefits that are not intended to be disallowed, including various tax credits such as the low income housing credit, energy production tax credit and energy credit that are claimed “in a transaction pursuant to which, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage.”⁶

With respect to leasing transactions, it further states that “[l]easing transactions, like all other types of transactions, will continue to be analyzed in light of all of the facts and circumstances.”⁷

The courts have a longstanding and well-established set of standards for determining the validity of a leasing transaction.⁸

The IRS has had outstanding for the last three decades the Leveraged Leasing Guidelines that establish a safe-harbor for providing an advance ruling that a transaction is a “true lease” for United States federal income tax purposes.⁹ Among the requirements of the Leveraged Leasing Guidelines are requirements for the lessor’s minimum at-risk equity investment,¹⁰ end of term residual value,¹¹ required profit¹² and pre-tax cash flow.¹³ The IRS,¹⁴ courts¹⁵ and

⁵ *Id.* at 153, fn 344.

⁶ *Id.* at 152, fn. 344.

⁷ *Id.* at 153.

⁸ *Id.* at 153, fn 350. A number of the judicial authorities concerning leasing are set forth in the Joint Committee Explanation. The cases cited indicate standards for so-called LILO and SILO transactions that are different than for traditional leveraged lease financing transactions. The focus of our comments are traditional leasing transactions used to provide financing of assets that are the subject of Tax Investment Incentives and do not rely on techniques such as economic defeasance or “loop debt.”

⁹ These Leveraged Leasing Guidelines were first published in 1975.

¹⁰ Rev. Proc. 2001-28, §§ 4.01(1), (2).

¹¹ Rev. Proc. 2001-28, § 4.01(3).

¹² Rev. Proc. 2001-28, § 4.06(1).

¹³ Rev. Proc. 2001-28, § 4.06(2).

Congress¹⁶ have generally viewed the Leveraged Leasing Guidelines as creating a safe-harbor for structuring lease transactions.

As noted, the Notice does not refer to the general standards articulated in the Joint Committee Explanation much less provide the type of further clarification that would help our members structure their investment transactions. Instead, the Notice ominously promises further case law development, presumably as the IRS challenges and litigates new cases with taxpayers resisting imposition of the 40 percent strict liability penalty.

ELFA Members Need Guidance

Our members are responsible for a significant volume of the annual investment in equipment and facilities made in the United States. When Congress enacts legislation providing Investment Tax Incentives, it is speaking to our membership. In order for our members to respond to Congressionally mandated Investment Tax Incentives in the manner Congress intends, they need a reasonable level of certainty that they will be able to keep the tax incentives they are paying for. For many of our members, the risk of loss of a tax benefit that has been priced into an investment, not to speak of a strict liability penalty of 40 percent (or even 20 percent) is not an acceptable level of risk.

The failure to provide useable guidance concerning the application of Section 7701(o) to everyday transaction structures for investments in assets entitled to Investment Tax Incentives will likely work against the Congressional goal of increasing investment in such equipment and

¹⁴ See, e.g. P.L.R. 1983-32-005 (Feb. 25, 1983) (“If upon audit, it is ascertained that a transaction is structured in such a manner that it satisfies all the criteria in [the Leveraged Leasing Guidelines] and the conduct of the parties is consistent therewith, it can be assumed that the Service will not recharacterize the lease.”).

¹⁵ See, e.g. *Thomas Est. v. Comr.* 84 T.C. 412, 440, n. 51 (1985) (describing the Leveraged Leasing Guidelines as “‘safe haven’ revenue procedure”).

¹⁶ See, e.g. Department of the Treasury, 106th Cong., *The Problem of Corporate Tax Shelters – Discussion, Analysis and Legislative Proposals*, at 95, n. 352 (1999) (“Both the Congress and the Administration have implicitly and explicitly allowed leveraged leases to stand undisturbed, subject to certain tolerances (see, e.g., Rev. Proc. 75-21, 1975-1 C.B. 367).”).

facilities. In order to minimize this problem and maintain the flow of investment capital, we urge the issuance of a supplement to Notice 2010-62 that makes a specific and favorable reference to the Profit and Positive Cash Flow requirements of Section 4.06 of the Rev. Proc. 2001-28, and provide straight forward rules for addressing tax credits. We have provided our recommendations for this guidance in greater detail in our earlier submission, a copy of which is attached for your convenience.

We would appreciate the opportunity to discuss further our member's concerns and potential solutions with the Treasury Department and IRS. For more information please contact David Fenig, ELFA's Vice President for Federal Government Relations at 202-238-3419 or dfenig@elfaonline.org

Respectfully submitted,

EQUIPMENT LEASING AND FINANCE
ASSOCIATION (ELFA)

By: _____

William G. Sutton, CAE
President

Attachment-ELFA Submission June 2010

Equipment Leasing and Finance Association

ELFA is the trade association that represents financial services companies and manufacturers in the \$521 billion U.S. equipment finance sector. Equipment finance provides a significant source of funding for both small and large commercial enterprises in the United States and is a significant contributor to capital formation in the U.S. and abroad. Overall, business investment in equipment and software accounts for 8.0 percent of the U.S. Gross Domestic Product (GDP) and the commercial equipment finance sector contributes about 4.5 percent to the GDP.

ELFA members are the driving force behind the commercial equipment finance market, providing credit every business day to nearly every business sector in the country. ELFA members finance the acquisition of all types of capital equipment, including commercial and corporate aircraft, rail cars and rolling stock, trucks and transportation equipment, vessels and containers, construction and off road equipment, medical technology and equipment, IT equipment and software and virtually every other type of equipment. ELFA has more than 500 members including (i) independent leasing and finance companies, (ii) captive finance

companies, (iii) commercial banks, (iv) diversified financial services companies, (v) investment banks and (vi) service providers including law firms, accounting firms, trustees, servicers, custodians and others who assist in the financing of equipment leases and loans. ELFA members include (a) many of the nation's largest financial services companies and manufacturers, (b) regional and community banks and (c) independent medium and small finance companies throughout the country. ELFA members' clients range from Fortune 100 companies to small and medium sized business enterprises to government agencies and non-profits.