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The Honorable Michael F. Mundaca
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The Honorable Jeffrey Van Hove
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Chief Counsel
Internal Revenue Service
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RE: Comments on Proposed Regulations
Expenditures Related to Tangible Property (REG-168745-03)

Dear Sirs:

The Equipment Leasing and Finance Association (ELFA) hereby submits these comments in response to proposed regulations published in the Federal Register on March 10, 2008, under sections 162, 263(a), and 263A of the Internal Revenue Code (the "Proposed Regulations"). The Proposed Regulations would provide guidance regarding the tax treatment of amounts paid to acquire, produce, or improve tangible property, and rules for determining the appropriate "unit of property." The ELFA's comments relate specifically to "materials and supplies" and "rotable spare parts" and their application to aircraft engines and the treatment of leased aircraft engines.

Background on ELFA

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 by 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 and engines, 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 members include (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 represents (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.

Discussion

ELFA respectfully requests the following clarifications to the Proposed Regulations with respect to the rules relating to "materials and supplies" and "rotable spare parts" as applied to aircraft engines. First, the final regulations should clarify that if the aircraft engine is acquired as part of an aircraft, the engine should be treated as a component part of the aircraft, and not as a "material and supply". Second, if an aircraft engine is a "spare," then even if the engine satisfies the definition of a "material and supply" under the final regulations it should be treated as a depreciable asset unless the taxpayer elects to treat the engine as a "material and supply." Finally, the final regulations should make clear that the treatment of leased aircraft engines is the same as the treatment of used aircraft engines.

Through its examples and otherwise, the Proposed Regulations appear to take the position that aircraft engines are "materials and supplies" and "rotable spare parts." This is confusing since it would necessarily mean that unless the taxpayer affirmatively elects to treat an aircraft engine as a depreciable asset, the costs of acquiring the aircraft engines would not be deductible until the taxable year in which the taxpayer disposes of the aircraft engine.

We question whether it is appropriate to make capital treatment and depreciation of aircraft engines contingent upon an election by the taxpayer on its return as the Proposed Regulations would provide. Aircraft engines are not the type of property commonly regarded as a material or supply that is "used or consumed" in the taxpayer's business in a single taxable year. Rather, aircraft engines are expensive and complex pieces of equipment that depreciate economically over a period of many taxable years as they are used in the taxpayer's business. Thus, the final regulations should be clear that if the engine is acquired as part of the aircraft, it should be treated as a component part of the aircraft, and not as a material and supply.

The final regulations should clarify that the engines in the example are not materials and supplies and that the costs of the engines are included in the basis of the aircraft and are depreciated as part of the aircraft, consistent with the conclusion that the engines are component parts of the aircraft. This should be the result unless the taxpayer affirmatively elects to treat the engine as a "material and supply" of the aircraft. Only in the event of such an affirmative election should the cost of acquiring or producing a spare engine that is a "rotable spare part" be deductible in the taxable year in which the taxpayer disposes of the aircraft engine.

We suggest changing the final regulations to provide that a taxpayer generally is required to capitalize the costs of acquiring or producing an aircraft engine that otherwise would be considered a "material and supply" under Prop. Treas. Reg. § 1.162-3(d) (*i.e.*, a "spare" aircraft engine). Thus, such costs generally would be recoverable through depreciation deductions under section 168 over the applicable recovery period for the engine. We further suggest, however, that if an aircraft engine otherwise satisfies the definition of a "material and supply," the taxpayer be permitted to elect to treat the engine as a material and supply, the acquisition or production costs of which (in the case of an aircraft engine that is a rotable spare part) is "used and consumed" in the taxable year in which the taxpayer disposes of the aircraft engine under paragraph (b) of that regulation.

We also recommend that the final regulations clarify the treatment of leased aircraft engines. Specifically, the final regulations should add to the examples a fact pattern that includes a taxpayer in the business of leasing the aircraft and engines to customers, with the results of the example being the same as if the taxpayer used the aircraft and engines directly. (For example, see Example 1 in the Proposed Regulations, where the results would be the same, *i.e.*: (1) the engines would be components of a single unit of property (the aircraft); and (2) the cost of conducting the engine shop visits ESVs on the engines would be deductible under the routine maintenance safe harbor of Prop. Treas. Reg. § 1.263(a)-3(e).

Further, the final regulations should add language to clarify that if a taxpayer acquires or produces a "spare" engine that it leases to a customer for use as a rotable spare part, the engine would be a "rotable spare part" in the hands of the taxpayer/lessor under the final regulations, just as it would be if the taxpayer itself had used the spare aircraft engine as a rotable spare part in a business of operating the aircraft itself. For the reasons set forth above, we believe that the spare engine in the leasing situation should be considered to be a capital asset subject to an allowance for depreciation unless the taxpayer instead elects to treat the engine as a material and supply, the acquisition or production cost of which would be deductible in the taxable year in which the taxpayer disposes of the engine.

Finally, we suggest that the final regulations provide rules under which a taxpayer may elect to treat a stock of spare parts as a single capital asset (*i.e.*, a single unit of property) under Prop. Treas. Reg. § 1.162-3(e). The Proposed Regulations appear to contemplate that a separate election under paragraph (e) has to be made with respect to each individual spare part. In example 11 of Prop. Treas. Reg. § 1.162-3(f), there is a statement that "X may elect under paragraph (e) of this section not to apply the rule contained in paragraph (a)(1) of this section to ***each of*** its temporary spare parts. X makes this election by capitalizing the amounts paid for ***each spare part*** in the taxable year the costs are incurred and by beginning to recover the costs

of ***each part*** on its timely filed Federal income tax return for the taxable year . . . .". We believe the final regulations should clarify that a stock of spare parts could be treated as a single capital asset by way of an election. Such a rule is particularly appropriate in the case of a stock of spare parts that a taxpayer leases to customers. In such a case, for ease of administration, taxpayers should be permitted to make a single election under paragraph (e) to treat the entire stock of spare parts as a single capital asset.

Thank you for the opportunity to comment on these important regulations. We look forward to discussing our comments with you directly at your convenience.

Respectfully submitted,

EQUIPMENT LEASING AND FINANCE ASSOCIATION (ELFA)

By: _____

William G. Sutton, CAE
President