

Part III - Administrative, Procedural, and Miscellaneous

Request for Comments on Property Simultaneously Held for Sale or Lease (“Dual-Use Property”)

Notice 2013-13

I. PURPOSE

This notice invites comments regarding whether construction and agricultural equipment held simultaneously for sale or lease to customers (“dual-use property”) by a dealer in such equipment is properly treated as inventorable property or as depreciable property for purposes of § 167 of the Internal Revenue Code. This notice also invites comments on whether, and under what circumstances, dual-use property may be eligible for like-kind exchange treatment under § 1031.

II. BACKGROUND

Dealers in construction and agricultural equipment purchase equipment from a manufacturer and generally seek to resell the equipment to customers as soon as possible. However, to accommodate particular needs of its customers, a dealer may lease equipment to a customer prior to selling it. Ordinarily, dealers reacquire their leased equipment upon termination of the lease and thereafter hold the equipment for varying periods before re-leasing or selling it. Alternatively, the lessee may purchase the leased equipment rather than return it to the dealer upon termination of the lease. Dealers ultimately dispose of all construction and agricultural equipment by sales, exchanges, or abandonment.

Section 167(a) allows, as a depreciation deduction, a reasonable allowance for

the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income.

Section 1.167(a)-2 of the Income Tax Regulations provides that no depreciation deduction may be taken with respect to inventories or stock in trade.

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 such 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.

Section 1031(a)(2)(A) provides that like-kind exchange treatment is not allowed for any exchange of property that is stock in trade or other property held primarily for sale.

The Internal Revenue Service has presumptively treated dual-use property held by a dealer as inventoriable property that is not eligible for depreciation deductions. Rev. Rul. 75-538, 1975-2 C.B. 35. To rebut this presumption, the IRS has required the dealer to show that the property was actually used in the dealer's business and that the dealer looks to consumption through use of the property in the ordinary course of business operation to recover the dealer's cost. Rev. Rul. 75-538; see also Rev. Rul. 89-25, 1989-1 C.B. 79. As a factual matter, it can be difficult to discern whether dual-use property is held primarily for sale to customers in the ordinary course of business or as an asset used in a trade or business. Compare Latimer-Looney Chevrolet, Inc. v. Commissioner, 19 T.C. 120 (1952), acq. 1953-1 C.B. 5 (new automobiles were "held for

use in a trade or business” where automobile dealer provided them to employees for use in the business prior to sale), with Duval Motor Co. v. Commissioner, 264 F.2d 548 (5th Cir. 1959), aff’g 28 T.C. 42 (1957), and Johnson-McReynolds Chevrolet Corporation v. Commissioner, 27 T.C. 300 (1956) (new automobiles were “property held for sale to customers” where automobile dealer temporarily removed them from inventory for use by employees).

Construction and agricultural equipment that is treated as inventoriable dual-use property under the presumption is not eligible for § 1031 like-kind exchange treatment because it is property held primarily for sale within the meaning of § 1031(a)(2)(A). Conversely, if the presumption is rebutted and the construction and agricultural equipment is treated as depreciable dual-use property, it may be eligible for § 1031 like-kind exchange treatment if the requirements of § 1031 are satisfied, including the requirement that the property is not held primarily for sale at the time of disposition.

III. REQUEST FOR COMMENTS

To minimize disputes between the IRS and dealers in construction and agricultural equipment, the Treasury Department and the IRS are considering issuing guidance that clarifies the circumstances under which construction and agricultural equipment that is dual-use property is properly treated either as inventoriable property or as depreciable property. Guidance is also being considered concerning whether exchanges of construction and agricultural equipment that is dual-use property are eligible for § 1031 like-kind exchange treatment or whether these exchanges are

ineligible for § 1031 because the equipment is treated as “stock in trade or other property held primarily for sale” within the meaning of § 1031(a)(2)(A).

The Treasury Department and the IRS request public comments to assist in developing this guidance. Specifically, comments are requested regarding the following items:

1. Factors that are relevant in determining whether construction and agricultural dual-use property is inventoriable or depreciable property, or eligible for § 1031 like-kind exchange treatment. For example, the following factors have previously been considered by the Service to be relevant:

(a) The dealer’s prior business experience with dual-use property, including the proportion of the dealer’s total dual-use property that is leased and the number of times the same property is leased or re-leased by the dealer prior to disposition;

(b) Whether dual-use property may be leased (or held for subsequent lease) for a period exceeding its recovery period for depreciation purposes;

(c) The proportion of annual lease revenue to total revenue, the proportion of annual lease revenue to revenue from sales of leased property, and the proportion of revenue from sales of leased property to annual sales revenue;

(d) Whether lease agreements customarily allow the dealer to terminate the lease and reacquire the property at any time without penalty (and, if so, the frequency with which the dealer exercises this option);

(e) For lease agreements that provide a purchase option, the frequency with which the lessee exercises this option and whether the lessee receives a price reduction;

(f) The manner in which dual-use property is typically disposed of (e.g. sold to lessee, at auction, or through a third-party); and

(g) The dealer's initial classification of dual-use property (as inventoriable or depreciable property) for federal income tax and financial accounting purposes.

Comments are also requested on whether any such factors should be evaluated separately for different classes or product lines of equipment.

2. Whether a safe harbor or bright-line test would be helpful in resolving these issues, and if so what methodology or criteria should be incorporated in such a safe harbor or bright-line test.

3. Whether guidance is needed for dealers of dual-use property, other than dealers in the construction and agriculture industries, regarding whether dual-use property is inventoriable or depreciable property, or eligible for § 1031 like-kind exchange treatment.

4. Whether the Industry Issue Resolution (IIR) process (see Rev. Proc. 2003-36, 2003-1 C.B. 859) would be a useful approach to resolving these issues.

Written comments should be submitted by June 16, 2013. Send submissions to CC:PA:LPD:PR (Notice 2013-13), Room 5203, Internal Revenue Service, P. O. Box

7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2013-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. Alternatively, comments may be submitted electronically to the IRS via the following e-mail address: Notice.Comments@irs.counsel.treas.gov. Please include "Notice 2013-13" in the subject line of any electronic communication. All comments will be available for public inspection and copying.

IV. DRAFTING INFORMATION

The principal author of this notice is Cheryl Oseekey of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Oseekey at (202) 622-4970 (not a toll-free call).