

Internal Revenue Service

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Refer Reply To:
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Date:
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TY:

LEGEND

Taxpayer =
State A =
SalesCo =

Dear

This responds to your request for a private letter ruling, dated November 1, 2012, concerning whether an exchange accommodation titleholder is a disqualified person within the meaning of § 1.1031(k)-1(k) of the Income Tax Regulations.

FACTS

Taxpayer, a State A corporation, uses the accrual method as its overall method of accounting and an annual accounting period ending on December 31. Its business is leasing vehicles. As leases terminate, Taxpayer exchanges used vehicles for new vehicles.

Taxpayer proposes to use an exchange accommodation titleholder (EAT) under Rev. Proc. 2000-37, 2000-2 C.B. 308, for its exchanges. Taxpayer intends to both defer gain under § 1031 of the Internal Revenue Code and take advantage of certain state-provided incentives for trade-in transactions.

Acquisition of Vehicles:

Taxpayer will acquire new vehicles (Replacement Property) in exchanges for its used vehicles (Relinquished Property) from various original equipment manufacturers (OEMs) through an EAT and a qualified intermediary (QI) in accordance with Rev. Proc. 2000-37, Rev. Proc. 2003-39, 2003-1 C.B. 971, and § 1.1031(k)-1 of the regulations

pertaining generally to deferred like-kind exchanges. When Taxpayer needs a new vehicle, Taxpayer will issue EAT a purchase order for the new vehicle and assign QI its rights to acquire the new vehicle from EAT. Subsequently, EAT will issue to OEM a purchase order for the new vehicle. OEM will then issue an invoice and manufacturer's statement of origin (the MSO) pertaining to a new vehicle to EAT. The invoice and MSO are qualified indicia of ownership for the new vehicle until issuance of the certificate of title for the vehicle. EAT will pay OEM for the new vehicle with money that Taxpayer loans to EAT. After receiving these documents, EAT will issue an invoice to Titling Trust (TTrust), reflecting a net taxable price (gross price at cost, including improvements, minus trade-in allowance). Also, EAT will endorse the MSO to TTrust.

TTrust is a Delaware business trust with subsidiary or "sub-trust" interests, including T-Sub and E-Sub. Bank, an entity unrelated to Taxpayer, is the trustee of TTrust. Taxpayer is sole beneficiary of its sub-trust (T-Sub) and EAT is sole beneficiary of its sub-trust (E-Sub). Pursuant to both § 301.7701-2(c)(2)(i) of the regulations and the trust agreement establishing TTrust, T-Sub and E-Sub are separate subtrusts of TTrust wholly and separately owned by Taxpayer and EAT respectively. Also, T-Sub and E-Sub are separate business entities disregarded for federal income tax purposes. Taxpayer is treated as directly owning the assets allocated to T-Sub and EAT is treated as directly owning the assets allocated to E-Sub. Accordingly, during the entire exchange period, EAT will hold and retain qualified indicia of ownership of the new vehicle.

Under state law, a sale occurs between EAT and TTrust when EAT transfers an invoice and endorses the MSO to TTrust. The documents are then presented to the appropriate state Department of Motor Vehicles (DMV) for a new title in the name of TTrust. Typically, taxes are due and paid to the DMV at the time of titling.

Taxpayer, as administrative agent for TTrust, will produce a report that allocates vehicles identified as EAT vehicles to E-Sub when purchased on the delivery date. This will occur by book entry on any day there is a purchase order entered for an EAT vehicle. On a daily basis, Taxpayer will notify EAT and QI of the vehicles acquired by EAT and allocated to E-Sub. Taxpayer will identify these vehicles by (i) Taxpayer Unit Number and (ii) make, model, and year of the vehicles. This notification will also include language advising EAT of Taxpayer's assignment to QI of Taxpayer's rights in the Qualified Exchange Accommodation Arrangement (QEAA) to purchase vehicles from EAT. In the Master Exchange Agreement (MEA), Taxpayer provides QI with a blanket assignment of Taxpayer's rights in the QEAA to purchase EAT vehicles from EAT.

EAT will hold qualified indicia of ownership of the vehicles allocated to E-Sub while improvements are made to the vehicles. For that need additional improvements, OEM will deliver the vehicles to a secondary equipment manufacturer (SEM), which completes the improvements and issues an invoice to EAT. EAT will enter

into a management agreement with Taxpayer by which Taxpayer will work with SEM to improve the vehicles. Taxpayer will loan additional money to EAT to pay SEM for any improvements made to the vehicles while the vehicles are held by EAT. When the vehicles are ready to be placed in service, Taxpayer, as administrative agent for TTrust, will prepare and issue the required notices for transfer of the vehicles from EAT's E-Sub to Taxpayer's T-Sub.¹ The QEAA provides that transfer of beneficial ownership of new vehicles to Taxpayer occurs when the vehicles are allocated from E-Sub to T-Sub and placed in service for use by Taxpayer's customers. The new vehicles will remain titled in TTrust before and after the reallocation from E-Sub to T-Sub.

Disposition of Vehicles:

Under the exchange arrangement, when a lessee returns a vehicle at the end of a lease term, Taxpayer will endorse the vehicle title to EAT on behalf of TTrust, pursuant to a power of attorney. EAT, acting merely as a conduit, immediately will endorse and transfer the title to another Taxpayer entity, Taxpayer Sales Company (hereafter "SalesCo"), and sell the vehicle to SalesCo pursuant to a contract for sale. SalesCo is a State A single-member LLC that is wholly owned by Taxpayer and is disregarded for federal income tax purposes. SalesCo has not and will not elect to be treated as a corporation for federal income tax purposes. For federal income tax purposes, Taxpayer characterizes the transfers from TTrust to EAT to SalesCo as a conduit transaction with EAT acting as SalesCo's purchasing agent. SalesCo will assign its rights to sell the used vehicle to QI under the MEA and SalesCo will provide notice of such assignment to a third party buyer on or before the date of sale. SalesCo will then sell the vehicle to the buyer, delivering the bill of sale and endorsed title and vehicle in exchange for payment to the joint Taxpayer/QI collection account.

Exchange Accommodation Titleholder:

EAT is an independent entity unrelated to Taxpayer. Neither EAT nor its affiliates will provide services to Taxpayer or its affiliates in the two years preceding an exchange other than the services mentioned herein. For state sales tax purposes, EAT is a procurement entity. In that capacity, EAT will (1) acquire a dealer license for state sales tax purposes and a wholesale dealer license of motor vehicles; (2) act as the procurement entity and reseller for state sales purposes; (3) acquire legal title to used vehicles (Relinquished Property) and to new vehicles (Replacement Property); (4) register to do business as a foreign corporation in any and all states where Taxpayer has transactions; and (5) obtain and maintain a valid sales tax permit in virtually every state that levies a sales tax. The used vehicles transferred through EAT in this manner are not subject to the QEAA because EAT will act as a mere conduit of title between Taxpayer and its wholly owned disregarded entity, SalesCo.

¹ Transfers within TTrust between the EAT's E-Sub and Taxpayer's T-Sub do not require transfers of legal title and, as such, are not treated as sales for state sale and use tax purposes and will not require the issuance of new titles or registrations at the state DMVs.

Taxpayer represents that in all other respects, its exchange procedures comply with the requirements of § 1031(a) of the Code, § 1.1031(k)-1 of the regulations, Rev. Proc. 2000-37 and Rev. Proc. 2003-39.

LAW AND ANALYSIS

Section 1031(a)(1) of the Code 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 to be held either for productive use in a trade or business or for investment.

Section 1.1031(k)-1 allows taxpayers to use a qualified intermediary to facilitate a like-kind exchange. Section 1.1031(k)-1(g)(4)(iii) defines a qualified intermediary as a person who-- (A) is not the taxpayer or a disqualified person, and (B) 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.

Section 1.1031(k)-1(k)(2) provides that the term "disqualified person" includes an agent of the taxpayer at the time of the transaction. For this purpose, 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, performance of the following services is not taken into account in determining whether a person is a disqualified person: (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.²

In Example 1 of § 1.1031(k)-1(k)(5), C, the taxpayer's accountant, renders accounting services to the taxpayer unrelated to the taxpayer's intended § 1031 exchange within two years of the exchange. The example concludes that C is a disqualified person because C acted as the taxpayer's accountant within the two-year period ending on the date of the exchange. Had C not acted as the taxpayer's accountant within two years of the exchange, or if C had acted as the taxpayer's accountant only with respect to intended § 1031 exchanges, C would not be a disqualified person.

² In addition, § 1.1031(k)-1(k)(3) and (4)(i) generally provides that a person who bears a relationship (as described in either § 267(b) or § 707(b), determined by substituting in each section "10 percent" for "50 percent" each place it appears) with either the taxpayer or a person described in § 1.1031(k)-1(k)(2) is a disqualified person.

Rev. Proc. 2000-37, as modified by Rev. Proc. 2004-51, 2004-2 C.B. 294, provides a safe harbor under which the Internal Revenue Service will treat an EAT as the beneficial owner of property for federal income tax purposes if the property is held in a QEAA. Rev. Proc. 2000-37 allows taxpayers to park exchange properties (either replacement or relinquished properties) with an EAT during the maximum permitted 180-day period, until the taxpayer is ready to complete the exchange. Section 4.02(1) of Rev. Proc. 2000-37 provides that neither the exchanging taxpayer nor a disqualified person may act as an EAT under a QEAA.

Section 4.03 of Rev. Proc. 2000-37 provides that property will not fail to be treated as being held in a QEAA as a result certain legal or contractual arrangements (whether or not such arrangements contain terms that typically would result from arm's length bargaining between unrelated parties). What follows is a list of approved arrangements, including:

- (a) Leasing of property by the EAT to the taxpayer or a disqualified person (clause (4));
- (b) Managing, supervising construction of improvements, or providing other services with respect to the property to the EAT (clause (5)); and
- (c) Entering into agreements relating to the purchase or sale the exchange property, including puts and calls at fixed or formula prices by the EAT and the taxpayer (clause (6)).

In *J. H. Baird Publishing Co. v. Commissioner*, 39 T.C. 608 (1962), *acq.* 1963-2 C.B. 4, the court held that the taxpayer's exchange met the requirements of § 1031 even though the party hired to serve as the taxpayer's intermediary constructed a new building on the replacement property before transferring it to the taxpayer.

In the present case, EAT acts as the procurement company reseller for state sales tax purposes. EAT acquires legal title to Relinquished Property and Replacement Property, obtains certain licenses and makes certain registrations. EAT must register to do business as a foreign corporation in any and all states where Taxpayer has transactions. Also EAT must obtain and maintain a valid sales tax permit in virtually every state that levies a sales tax. However, the performance of these services does not result in EAT being a disqualified person with respect to Taxpayer's exchanges. As discussed above, intermediaries may perform a variety of tasks and functions that are reasonably connected with facilitating exchange transactions without disqualifying their status as qualified intermediaries or exchange accommodation titleholders. Although EAT's services are not expressly described in section 4.03 of Rev. Proc. 2000-37, they are akin to the services described in Rev. Proc. 2000-37 because they are services "for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031." Consequently, EAT's services are

ignored in determining whether EAT is a disqualified person and EAT is not a disqualified person for Taxpayer as a result of providing such services.

RULING

The performance of services by EAT for Taxpayer related to the state sales tax trade-ins with respect to Taxpayer's exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031 of the Code, does not make EAT a disqualified person for the exchanges.

DISCLAIMERS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Michael J. Montemurro
Branch Chief, Branch 4
(Income Tax & Accounting)

cc: