Part I

Section 482

26 CFR 1.482-1: Reallocation of income and deductions among unrelated parties to a lease strip

Rev. Rul. 2003-96

ISSUE

Whether section 482 may apply to allow allocations of the income and deductions arising from the property that is the subject of a lease stripping transaction entered into and effected among parties that were unrelated up to and including the time income is stripped from the lease pursuant to a plan promoted to realize tax benefits for one or more of the parties, solely on the basis that at such time the parties were acting in concert or with a common goal or purpose to arbitrarily shift income or deductions among themselves.

FACTS

A, a foreign corporation, purchases property from B, an equipment leasing company. At the time of the purchase, the property was subject to pre-existing end user leases with varying terms extending over future years. A is not engaged in a trade or business within the United States and is exempt from U.S. taxation on U.S. source income, if any, from the end user leases under an applicable income tax treaty. A sells the right to all future rental income attributable to the end user leases to C.

D, a domestic corporation, is the parent of an affiliated group of corporations that files a U.S. consolidated income tax return. After the rights to the future rental income have been sold to C, A transfers the leased property subject to the end user leases to E, a domestic corporation, in a purported section 351 transaction entered into with D where immediately after the transaction, A has non-voting preferred stock in E and D has 100% of the voting stock of E. E is a member of the D consolidated group (the "D group") after the purported section 351 transaction. Subsequent depreciation deductions from the leased property are reflected on the consolidated return for the D group.

The foregoing steps were undertaken pursuant to a plan promoted by P to A, B, C, and the D group to achieve U.S. income tax benefits for one or more of the parties. A, B, C, the D group, and P were unrelated to one another at all times up to and including the time the income is stripped from the leases in the transaction between A and C, and A and D also were unrelated to one another throughout the period in which tax benefits are claimed with respect to the lease stripping transaction.

LAW and ANALYSIS

Section 482 provides, in part:

> In the case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations.

In determining whether or not two or more organizations, trades, or businesses are controlled directly or indirectly by the same interests, control is defined to include any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. Treas. Reg. § 1.482-1(i)(4). It is the reality of control that is decisive, not its form or the mode of its exercise. Id.; Ach v. Commissioner, 42 T.C. 114 (1964), aff'd, 358 F.2d 342 (6th Cir.), cert. denied, 385 U.S. 899 (1966). A presumption of control arises if income or deductions have been arbitrarily shifted. Treas. Reg. § 1.482- 1(i)(4).

The issue under section 482 is whether an allocation between or among organizations, trades, or businesses owned or controlled by the same interests is necessary to prevent the evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses. Therefore, situations in which two or more taxpayers act in concert to control another organization, trade or business with a common goal or purpose to arbitrarily shift income or deductions between one or more of such taxpayers and the controlled organization, trade or business are brought within the application of section 482 by the reference in section 1.482-1(i)(4) to "control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose."

An example would be three equal and otherwise unrelated shareholders in a corporation that, acting in concert, individually purchase from or sell items to the corporation at prices that differ from those that would be charged by unrelated parties in similar circumstances. Even though none of the shareholders individually has actual or effective control of the corporation, where the shareholders act in concert with a common goal of shifting income or deductions from or to the corporation, section 1.482-1(i)(4) provides that each shareholder is considered to control the corporation for purposes of the application of section 482. See, e.g., B. Forman Co., Inc. v. Commissioner, 453 F.2d 1144 (2d Cir. 1972), cert. denied, 407 U.S. 934, rehearing denied, 409 U.S. 899 (1972), aff'g in part, and rev'g in part, 54 T.C. 912 (1970); South

Texas Rice Warehouse Co. v. Commissioner, 366 F.2d 890 (5th Cir. 1966), aff'g 43 T.C. 540 (1965), cert. denied, 386 U.S. 1016 (1967).

By contrast, the fact that unrelated parties engage in a transaction does not by itself evidence the type of control necessary to satisfy the "acting in concert or with a common goal or purpose" requirement of section 1.482-1(i)(4), regardless of whether such transaction may be viewed as having arbitrarily shifted income between the otherwise unrelated parties. An application of section 1.482-1(i)(4) to this type of situation would be inconsistent with the policies underlying section 482, which provides for allocations between or among organizations, trades or businesses "owned or controlled directly or indirectly by the same interests."

Under the facts, the lease stripping transaction occurred among parties that themselves were unrelated to one another up to and including the time the income is stripped from the leases. Up to and including the time the income is stripped from the leases, there were not two or more of such parties and another organization, trade or business which such parties acted in concert to control. Accordingly, at that time, the parties did not “act in concert or with a common goal or purpose” within the meaning of section 1.482-1(i)(4).

HOLDING

The facts described up to and including the time the income is stripped from the leases do not support the application of section 482 to allow the allocation among the parties of the income and deductions arising from the property that is the subject of the lease stripping transaction. The fact that parties that were unrelated up to and including the time of a transaction engage in that transaction in an attempt to arbitrarily shift income or deductions among themselves does not by itself evidence the type of control necessary to satisfy the "acting in concert or with a common goal or purpose" requirement of section 1.482-1(i)(4). This ruling does not address whether A is considered to control E for purposes of the application of section 482 by reason of A and D entering into the purported section 351 transaction with E.

No inference is intended concerning the treatment of lease stripping transactions for Federal income tax purposes. The Internal Revenue Service will challenge lease stripping transactions on other legal grounds. See Notice 2003-55 I.R.B. 2003-34, August 25, 2003.

DRAFTING INFORMATION

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