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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

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Date:
June 23, 2003

Legend

Leasco =

Parent =

Holding =

Business Trust =

Trustee =

State 1 =

State 2 =

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p =

$a =

Dear

This responds to a letter dated August 23, 2002, submitted on behalf of Leasco, requesting rulings under § 7701(h) of the Internal Revenue Code.

According to the facts submitted and representations made, Parent is a closely held State 1 corporation that is the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. Leasco, the principal operating subsidiary of Parent, is engaged in the motor vehicle fleet leasing business and has a motor vehicle fleet in excess of n vehicles. Leasco's customers lease from o to more than p vehicles. The vast majority of Leasco's customers have high-quality credit. Historically, rental defaults by Leasco's customers have been extremely low. For each customer there is a Master Lease Agreement and a Lease Order for each new vehicle added to the master lease.

Leasco provides the following services to its customers: 1) vehicle acquisitions services and maintenance and collision services; 2) license, title and tax administration services; 3) remarketing services; 4) data processing services; 5) truck engineering and coordination services; 6) gasoline credit card administration; 7) rental replacement vehicles; and 8) administration of factory incentives.

Leasco (or a limited liability company wholly-owned by Leasco) historically has financed a substantial portion of its vehicle acquisition costs. The borrowed funds have been provided by a consortium of banks and other financing sources on a full recourse basis with the debt secured by a lien on the vehicles and a pledge of the rentals payable under the vehicle leases. Leasco proposes to change the form of its financing arrangements in order to provide security other than a direct lien on the vehicles for the financing sources.

Leasco will form Holding, a State 2 limited liability company of which Leasco will be the sole member. Holding will be capitalized by a contribution from Leasco. Holding, will establish a Business Trust under the laws of State 1.

Holding will be initially capitalized with $a. This amount will be Holding's minimum capital, and such minimum capital amount will exist at the inception of every new borrowing. No distribution of any capital to Leasco will be made by Holding except upon liquidation. To the extent that such minimum capital is reduced to an amount less than $a, as for example, in the event of losses, minimum capital must be restored by additional capital contributions by Leasco prior to the consummation of a new borrowing. No third party rights to force additional capital contributions are created.

Holding will from time to time borrow funds on a full recourse basis from Leasco under a letter loan agreement (the "Letter Loan Agreement"). Holding will contribute the funds to the Trust. Holding will initially pledge its undivided trust interest in the Business Trust evidenced by an undivided trust interest certificate (the "UTI Certificate") to Leasco as security for the payment of its borrowing from Leasco. Subsequently, Holding will cause the Business Trust to create a sub-trust comprised of identified vehicles and leases, which will be allocated to a special unit of the beneficial interest (the "SUBI"), which will be evidenced by a certificate (the "SUBI Certificate"). Holding will sell the SUBI Certificate to Leasco pursuant to a SUBI Certificate Transfer Agreement. To purchase the SUBI Certificate from Holding, Leasco will borrow funds from a consortium of lenders on a full recourse basis and secured by the SUBI

Certificate.

Leasco, as agent for the Business Trust under the Servicing Agreement, will collect all amounts payable under a lease and all net disposition proceeds. Such rentals and net disposition proceeds allocable to the SUBI will be distributed to Leasco, as the holder of the SUBI. Leasco will use the funds to pay Leasco's borrowing. If disposition proceeds are such that the lessee is entitled to receive a payment at the termination of the lease under the terminal rental adjustment clause ("TRAC Payment"), the obligation to make the TRAC payment will be satisfied out of funds held by the Business Trust or contributed to the Business Trust by the entity that holds the SUBI to which the lease is allocated. Leasco will receive a servicing fee out of the Business Trust Assets allocated to the SUBI equal to a dollar amount per month, per vehicle, for providing services under the Servicing Agreement. Assuming rental defaults are consistent with historical experience, amounts received by the Business Trust should be sufficient for Holding or Leasco to satisfy obligations to lenders and make a profit.

Because Holding's liability to Leasco will be a full recourse obligation, Leasco will be able to look not only to the UTI Beneficial Interest in the Trust, but also to all of Holding's assets, subject to the ordinary debtor-creditor priority rules. Similarly, because Leasco's liability to the lenders will be a full recourse obligation, the lenders will be able to look not only to the SUBI, but also to all of Leasco's assets, subject to ordinary debtor-creditor priority rules.

The Business Trust shall have authority 1) at the direction of Holding, as the UTI Beneficiary, to enter into leases directly and to take assignments and conveyances of, hold in trust and release its ownership interest in, identified vehicles and leases and payments with respect to the vehicles as nominee of legal title for the benefit of Holding, or the party specified by the UTI beneficiary in a supplement to the Business Trust Agreement (the "SUBI Supplement"), 2) to enter into and perform its obligations under the Business Trust documents, 3) to engage in any of the other activities authorized in the Business Trust Agreement, any supplement or any amendment thereto, and 4) to engage in any activities that are appropriate to accomplish the foregoing or that are incidental therewith.

Almost all the leases to be entered into by the Business Trust will be open-ended. In an open-end lease, a lessor will receive a payment from the lessee at the termination of the lease if the vehicle's disposition proceeds are lower than anticipated and will pay an amount to the lessee if the vehicle's disposition proceeds are higher than expected. This rental adjustment feature is commonly referred to as a terminal rental adjustment clause ("TRAC").

Under the terms of the Master Lease Agreement, the Lessee is assured that the net proceeds of disposition shall be at least equal to 20 percent (30 percent if lease termination occurs in the first 12 months) of the fair market value of the vehicle at the beginning of the 12-month period ending that ends on the date of lease termination.

Parent, Leasco, and Holding request rulings that 1) the Master Lease Agreement

(and the Lease Order) pursuant to which the Business Trust is the lessor is a qualified motor vehicle operating agreement under § 7701(h)(2); 2) qualification of the Master Lease Agreement (and the Lease Order) as a lease, for federal income tax purposes, in the hands of the trust will be determined without regard to the TRAC provision of the Master Lease Agreement; 3) no gain, loss or income will be realized by Leasco or Holding as a result of the "loan" from Leasco to Holding or the "sale" of the SUBI Certificate by Holding to Leasco; 4) no gain, loss or income will be realized by Leasco or Holding as a result of the transfer of the property from Holding to Business Trust or from the Business Trust to Holding or Leasco; and 5) all income, deductions and credits of the Business Trust will be treated as income, deductions and credits of Leasco.

Rulings 1 and 2

Section 7701(h)(1) provides that in the case of a qualified motor vehicle operating agreement that contains a terminal rental adjustment clause, the agreement is treated as a lease if (but for such terminal rental adjustment clause) the agreement would be treated as a lease for federal income tax purposes, and the lessee is not treated as the owner of the property subject to the agreement during the period the agreement is in effect.

Section 7701(h)(2) defines a qualified motor vehicle operating agreement as any agreement with respect to a motor vehicle (including a trailer) that meets the following requirements. First, under the agreement, the sum of the amount the lessor is personally liable to repay, and the net fair market value of the lessor's interest in any property pledged as security for property subject to the agreement, must equal or exceed all amounts borrowed to finance the acquisition of property subject to the agreement. Any property pledged that is property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement is not taken into account. Second, the agreement must contain a separate written statement signed by the lessee that the lessee certifies, under penalty of perjury, that it intends that more than 50 percent of the use of the property subject to the agreement is to be in a trade or business of the lessee, and that clearly and legibly states that the lessee has been advised that it would not be treated as the owner of the property subject to the agreement for federal income tax purposes. Finally, the lessor must not know that the certification is false.

The facts and representations provided by Taxpayer indicate that the Master Lease Agreement and Lease Order will meet the definition of a "qualified motor vehicle operating agreement" under § 7701(h)(2). Accordingly, based on the foregoing facts, representations, and law, we rule that the Master Lease Agreement (and the Lease Order) pursuant to which the Business Trust is the lessor is a qualified motor vehicle operating agreement under § 7701(h)(2)). We also rule that qualification of the Master Lease Agreement (and the Lease Order) as a lease, for federal income tax purposes, in the hands of the trust will be determined without regard to the TRAC provision of the Master Lease Agreement.

Rulings 3, 4 and 5

Section 301.7701-2(b) of the Procedure and Administration Regulations provides that the definition of a corporation includes an association as determined under § 301.7701-3.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an "eligible entity") can elect its classification for federal tax purposes. An eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Section 301.7701-3(b)(1)(ii) provides that a domestic eligible entity with a single owner is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to be treated as a corporation. If the entity is disregarded, its activities are treated in the same manner as those of a division of its owner, and its assets will be treated as those of the owner.

Section 301.7701-4(a) provides that in general, the term "trust" refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purposes of protecting or conserving it for the beneficiaries. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 301.7701-4(b) addresses "business trusts" and provides that there are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect or conserve the property for the beneficiaries. These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under section 301.7701-2.

Based on the foregoing facts, representations, and law, we conclude that Business Trust is a business trust as described in § 301.7701-4(b) and not a trust under § 301.7701-4(a). We further conclude that under § 301.7701-3(b)(1)(ii), both Business Trust and Holding are domestic eligible entities with a single owner that are disregarded as entities separate from their owner. Accordingly, we rule that no gain, loss or income will be realized by Leasco or Holding as a result of the transfer of money from Leasco to Holding or the transfer of the SUBI Certificate by Holding to Leasco. We further

conclude that no gain, loss or income will be realized by Leasco or Holding as a result of the transfer of the property from Holding to Business Trust or from the Business Trust to Holding or Leasco; and that all income, deductions and credits of the Business Trust will be treated as income, deductions and credits of Leasco. These rulings are conditioned upon the SUBI Certificate not creating an equity interest in the Business Trust or Holding for the consortium of lenders who are providing loans for which the SUBI Certificates are being used to secure such lending.

Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations. Specifically, no opinion is expressed concerning whether or not the Master Lease Agreement and Lease Order are true leases for federal income tax purposes.

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer and the taxpayer's second authorized representative.

Sincerely,

Carolyn Hinchman Gray
Senior Counsel, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes