Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: 200712044

Release Date: 3/23/2007

CC:ITA:B05:
POSTS-127926-06

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 9300.38-00, 6011.01-00

date: December 12, 2006

to:

(Large & Mid-Size Business)
Attn

from: John Aramburu
Senior Counsel
(Income Tax & Accounting)

---

subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

Trust =

Equipment =

Seller/Lessee =

Parent =

Custodian =

Y years =

A dollars =

B dollars =

C dollars =

D dollars =

ISSUES

Whether the described transaction is the same as or substantially similar to the sale-in, sale-out (SILO) transactions set forth in Notice 2005-13, 2005-1 C.B. 630.

CONCLUSION

The described transaction is the same as or substantially similar to the sale-in, sale-out (SILO) transactions set forth in Notice 2005-13.

FACTS

Under the relevant transaction documents, Taxpayer, utilizing Trust,[1] purports to purchase Equipment from Seller/Lessee. The purchase price of A dollars consists of B dollars contributed by Taxpayer and C dollars nominally borrowed by Taxpayer on a nonrecourse basis from a lender affiliate of Parent.

As part of the same transaction, Taxpayer leases the Equipment back to Seller/Lessee for a term of some Y years. At the end of the lease term, Seller/Lessee has the option of "returning" the Equipment to Taxpayer and paying a "Residual Value Guaranty Amount" (RVGA). Alternatively, Seller/Lessee can purchase the Equipment for an amount equal to the greater of the RVGA or the fair market value of the Equipment. The transaction also provides Seller/Lessee with a fixed price purchase option, which can be exercised at various points of the lease term. The purchase option price is funded by the payment undertaking agreements discussed below.

Of Taxpayer's equity investment in the Equipment, D dollars is transferred by Seller/Lessee to an "Equity Payment Undertaker," which, like lender, is an affiliate of Parent. This payment is characterized as a fee, and after payment the funds are not considered an asset of Seller/Lessee. In exchange for the fee, the Equity Payment

[1] Trust is treated as a grantor trust under the Subchapter J of the Internal Revenue Code, and therefore its items of income, deduction, etc., are attributed to Taxpayer.

Undertaker agrees to make certain payments on behalf of Seller/Lessee, including the "Equity Portion" of rent due pursuant to the lease, and the RVGA discussed above. The Equity Payment Undertaker's obligations are supported by a guaranty from Parent and are collateralized with amounts to be held by Custodian.

Similarly, Seller/Lessee transfers the debt portion of the Equipment's purchase price (C dollars) to a "Debt Payment Undertaker," also an affiliate of Parent. After payment, this amount likewise is not considered an asset of Seller/Lessee, but a fee paid for the Debt Payment Undertaker's agreement to make payments that satisfy certain Seller/Lessee obligations, including the obligation to pay the "Debt Portion" of rent on the lease. These rent payments also satisfy Taxpayer's obligation to repay the nonrecourse loan and are made directly by the Debt Payment Undertaker to the lender affiliate of Parent.

LAW AND ANALYSIS

In determining whether a transaction is "substantially similar" to a listed transaction, the following definition is set forth in section 1.6011-4(c)(4) of the regulations: "The term substantially similar includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. . . . Further, the term substantially similar must be broadly construed in favor of disclosure. "

The intended tax consequences of the transaction and those described in Notice 2005-13 are the same – deductions for depreciation, interest and amortization of transaction costs that exceed rent income during the early years of the transaction. Moreover, the transaction is factually similar to and is based on the same or similar tax strategy as the transactions described in Notice 2005-13.

One particular feature of the SILO transactions described in Notice 2005-13 present in this transaction is that the proceeds of the purported sale of property have been set aside, pursuant to payment undertaking agreements, to satisfy the tax-indifferent party's obligations under the transaction documents. In other words, those obligations, and the obligation of the taxpayer under the nonrecourse lending, are defeased. Defeasance means, among other things, that the tax-indifferent party cannot use any significant part of the proceeds of the sale for business purposes, such as to acquire or refinance equipment, as would be the case if the transaction were a financing cast as a sale and leaseback in order to take advantage of tax benefits. That the transaction does not serve even a financing role supports its characterization as little more than a sale of tax benefits.

Another feature of the transactions described in Notice 2005-13 is the retention, by the tax-indifferent party, of market risk with respect to the property's residual value. In the Notice, the tax-indifferent parties' purchase options give the tax-indifferent parties the opportunity to profit from greater than expected residual value. At the same time, the transactions contain terms that keep risk of loss due to unexpected decline in residual

value with the tax-indifferent party. In the case of "Service Contract" SILOs, the service contract option ensures that taxpayer will not suffer a loss of equity in the event of an unexpected decline in residual value. In the case of "QTE" (qualified technological equipment) SILOs, the taxpayer's equity investment is protected by residual value insurance.

In this case, we understand that Seller/Lessee may, at various points of the lease term, exercise a fixed-price purchase option and that payment of the purchase option price will return to Taxpayer its equity investment and a return on that investment. This purchase option provides Seller/Lessee with the opportunity to profit from the Equipment's residual value. At the same time, the Seller/Lessee, not Taxpayer, bears risk of loss from an unexpected decline in residual value, because the RVGA obligation ensures that Taxpayer will recover its investment and a return on that investment.

Considering all the facts and circumstances of this transaction, we conclude that the transaction is the same as, or substantially similar to, the transactions set forth in Notice 2005-13.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted]

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call at if you have any further questions.