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Department of the Treasury
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Date:
March 30, 2010

In Re:

LEGEND:

Taxpayer =

Company TP =

Company A =

Company B =

Company B1 =

Company B2 =

Company B3 =

Company C =

Company D =

Partnership =

Manufacturer =

Intermediary =

Institution =

Product =

Component A =

Component B =

Relinquished Property =

Replacement Property =

Country X =

Location A =

Location B =

Activity =

A% =

Dear :

This letter responds to your ruling request submitted on behalf of Taxpayer by letter dated September 30, 2009, as to (1) whether § 1031(f) precludes nonrecognition treatment under § 1031 in the transaction described below, and (2) if not, whether any gain or loss realized but not recognized under § 1031 by Company B will affect the foreign base company income and the earnings and profits of Company B.

STATEMENT OF FACTS

We rely on the facts, representations, and conditions set forth in Taxpayer's submissions dated September 30, 2009, January 27, 2010, and February 17, 2010.

Taxpayer, the common parent corporation of a group of corporations, files a consolidated U.S. Federal income tax return. Taxpayer conducts a global commercial Product leasing business under the trade name Company TP. Taxpayer indirectly wholly owns Company A, which is a domestic corporation and a member of the consolidated group. Company A indirectly wholly owns Company C and Company D, which are domestic corporations and members of the consolidated group. Company A also wholly owns, directly and indirectly, Company B, which is organized in Country X and classified as a corporation for U.S. Federal tax purposes. Company B is a controlled foreign corporation within the meaning of § 957(a). Company B, in turn,

wholly owns multiple companies in Country X that are disregarded as entities separate from Company B: Company B1, Company B2, and Company B3. Taxpayer owns indirectly A% of Partnership, which is a domestic limited partnership. Company A, Company B, Company C, and Company D are related parties within the meaning of § 1031(f)(3).

Company TP operates its Product leasing business through two operational centers: one in Location A for Product used in Activity, and the other in Location B for all other Product. At the end of a Product lease, Company TP customarily either disposes of or re-leases the Product. Depending on market conditions, it may be more profitable to dismantle the Product and sell the parts. Company TP's Component A parts business operates through wholly owned direct and indirect subsidiaries of Company A, including Company C. Company C acquires Component A by purchase or consignment, disassembles Component A, and sells the reconditioned parts from its warehouse in Location B. Company TP's Component B parts business operates through Partnership, which acquires Component B through purchase or consignment, disassembles Component B and services the parts, and sells the revamped Component B parts from the Partnership warehouse in Location B.

Company B proposes to dispose of and replace Relinquished Property through an exchange of like-kind property that is intended to qualify for nonrecognition treatment under § 1031(a). Company B2 leases Relinquished Property to customers for use in Activity. Company B2 will enter into a contract (Sale Agreement) with Company C and Company D for the sale of Relinquished Property. Company C will acquire the Component A and all parts other than the Component B on Relinquished Property and Company D will acquire the Component B on Relinquished Property.

Taxpayer represents that Replacement Property is like kind to Relinquished Property and will be used in Activity. Company A and Company B1, as joint and several purchasers, have entered into a purchase agreement (Purchase Agreement) with Manufacturer to purchase Replacement Property. Manufacturer is a domestic corporation not related to Taxpayer or any of Taxpayer's affiliates described above.

Prior to closing on the Sale Agreement, Company B2 will enter into an exchange agreement (Exchange Agreement) with Intermediary, which is a domestic corporation

unrelated to Taxpayer or any of Taxpayer's affiliates described above. Intermediary is a qualified intermediary as defined by § 1.1031(k)-1(g)(4), and not a "disqualified person" with respect to Taxpayer within the meaning of § 1.1031(k)-1(k). The Exchange Agreement will require Intermediary to acquire Relinquished Property from Company B2, transfer Relinquished Property, acquire a like-kind replacement property, and transfer the replacement property to Company B2. The Exchange Agreement will expressly limit Company B2's right to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the Intermediary as provided in § 1.1031(k)-1(g)(6).

Company B2, Institution, and Intermediary will enter into a trust agreement (Trust Agreement), in which Company B2 will be the beneficiary and Institution will be the trustee. Institution is not a disqualified person as defined in § 1.1031(k)-1(k). The Trust Agreement will expressly limit Company B2's right to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by Institution as provided in § 1.1031(k)-1(g)(6).

Pursuant to the Exchange Agreement, Company B2 will assign in writing its rights in the Sale Agreement to Intermediary. Company B2 will give to Company C and Company D written notice of the assignment of its rights in Relinquished Property on or before the date of the transfer of Relinquished Property. On the closing date of the Sale Agreement, Company C and Company D will pay their respective portions of the purchase price to Intermediary in cash, those amounts will be deposited in the trust, and Intermediary will direct in writing Company B2 to transfer title to Relinquished Property to Company C and Company D.

Prior to delivery of Replacement Property, Company A and Company B1 will assign in writing their rights and obligations under the Purchase Agreement to Company B3 (Assignment Agreement). Company B2 will assign, for value, its rights and obligations in the Exchange Agreement to Company B3. Pursuant to the Exchange Agreement, Company B3 will identify in writing Replacement Property as replacement property by midnight of the 45th day after the closing date for the sale of Relinquished Property.

Pursuant to the Exchange Agreement, Company B3 will assign in writing its rights, but not its obligations, under the Assignment Agreement to Intermediary. Company B3 will give to Manufacturer, Company A, and Company B1 written notice of the assignment of its rights in Replacement Property on or before the date of the transfer of Replacement Property.

Company B3 or Company B will pay to the Intermediary funds equal to the excess of the purchase price of Replacement Property over the proceeds from the sale of Relinquished Property held in the trust that are available for the purchase of Replacement Property.

Pursuant to the Exchange Agreement, Intermediary will direct in writing Manufacturer to transfer title to Replacement Property directly to Company B3. The transfer will occur by the earlier of midnight of the 180th day after the closing date for the sale of Relinquished Property or the due date of the Company B Federal tax return for the tax year in which Relinquished Property was transferred.

After the above transactions, Company B3 will own Replacement Property, and Company C and Company D will own Relinquished Property. Within two years of acquiring the Component A, Company C plans to dismantle the Component A and sell the dismantled parts of the Component A to a third party or parties not related to Company C or Company B. Depending on the market conditions for Component B at the time of the acquisition of the Component B, Company D will either lease the Component B to a customer or consign the Component B to Partnership, which will, within two years of Company D acquiring the Component B, dismantle the Component B and sell the dismantled parts of the Component B on behalf of Company D. Taxpayer anticipates that most of the parts will be sold to a third party or parties not related to Company D or Company B.

LAW AND ANALYSIS

Exchanges between Related Parties under § 1031(f)

Section 1031(a)(1) generally provides that no gain or loss shall be 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 which is to be held either for productive use in a trade or business or for investment.

Section 1031(f)(1) sets forth special rules for exchanges between related persons. Section 1031(f)(1) provides that if (A) a taxpayer exchanges property with a related person, (B) there is nonrecognition of gain or loss to the taxpayer in accordance with § 1031 with respect to the exchange, and (C) within two years after the date of the last transfer that was part of the exchange, either the taxpayer or the related person disposes of the property received in the exchange, then there is no nonrecognition of gain or loss in the exchange. In other words, the gain or loss that was deferred under § 1031 must be recognized as of the date of the disposition of the property received in the exchange (the second disposition).

The Ways and Means Committee Report discussing § 1031(f), H.R. Rep. No. 247, 101st Cong. 1st Sess. 1340 (1989), describes the policy concern that led to its enactment:

> Because a like-kind exchange results in the substitution of the basis of the exchanged property for the property received, related parties have engaged in

> like-kind exchanges of high basis for low basis property in anticipation of the sale of the low basis property in order to reduce or avoid the recognition of gain on the subsequent sale. . . . The committee believes that if a related party exchange is followed shortly thereafter by a disposition of the property, the related parties have, in effect, 'cashed out' of the investment, and the original exchange should not be accorded nonrecognition treatment.

Section 1031(f)(4) provides that § 1031 shall not apply to any exchange that is part of a transaction, or series of transactions, structured to avoid the purposes of § 1031(f). Thus, if a transaction is set up to avoid the restrictions of § 1031(f), § 1031(f)(4) operates to prevent nonrecognition of the gain or loss in the exchange. See Rev. Rul. 2002-83, 2002-2 C.B. 927 (nonrecognition treatment precluded under § 1031(f)(4) where related parties used qualified intermediary to circumvent the purposes of § 1031(f)(1)).

In the present case, § 1031(f)(1) is not applicable because Company B is exchanging property with Intermediary that is not a related person. In addition, § 1031(f)(4) does not apply to preclude nonrecognition because Company B, Company C, and Company D did not exchange properties either directly or through Intermediary. Company C and Company D did not own, prior to the exchange, any property that Company B will acquire in the exchange. Company B did not transfer Relinquished Property to Company C and Company D as part of a transaction or series of transactions structured to avoid the purposes of § 1031(f)(1). The related parties in this case did not exchange high basis property for low basis property in anticipation of the sale of the low basis property. Accordingly, Company C and Company D's proposed disposal of Relinquished Property within two years of the acquisition would not result in a "cashing out" of an investment or shifting of basis between Company B, Company C, and Company D.

Foreign Base Company Income and Earnings and Profits

Under § 1.952-2(a) and (b), the gross income and taxable income, respectively, of a foreign corporation (other than a foreign corporation that would be taxed as a life insurance company if it were domestic) for any taxable year shall be determined by treating such foreign corporation as a domestic corporation taxable under § 11 and by applying the principles of §§ 61 and 63 and the regulations thereunder, subject to certain limitations described in § 1.952-2(c) that do not apply in this situation. Because the income of a controlled foreign corporation is generally computed as if the corporation were domestic, the results of a valid § 1031 like-kind exchange are respected for purposes of computing the controlled foreign corporation's income. Accordingly, in a qualifying § 1031 exchange, a controlled foreign corporation has income only to the extent of gain recognition under § 1031, if any.

Further, any gain or loss realized but not recognized by a corporation pursuant to a valid § 1031 exchange will not affect the earnings and profits of the corporation for the year in which such gain or loss is realized but not recognized. See §§ 312(f)(1) and 1.312-7(b)(1). In the case of a controlled foreign corporation, section 964(a) states that, except as provided in § 312(k)(4) (relating to the effect of depreciation on the earnings and profits of certain foreign corporations), for subpart F purposes the earnings and profits of any foreign corporation, and the deficit in earnings and profits of any foreign corporation, for any taxable year, are determined by rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary. Under § 1.964-1(a), the earnings and profits (or deficit in earnings and profits) of a foreign corporation for its taxable year are computed substantially as if such corporation were a domestic corporation, by preparing a profit and loss statement with respect to such year from the books of account regularly maintained by the corporation and making any necessary adjustments as described in § 1.964-1(b) and (c).

RULINGS

Based on the given facts and representations:

(1) Section 1031(f) will not preclude nonrecognition treatment in the transaction described above.

(2) To the extent that all other requirements of § 1031 are satisfied so that any gain or loss resulting from the above-described transaction is realized but not recognized, Company B will not recognize any income or loss from the transaction and, as a result, no amount of realized but unrecognized gain from the transaction will be treated as foreign base company income, as determined under § 954, for the year in which the gain or loss is realized but not recognized.

(3) Assuming no gain or loss will be recognized as a result of § 1031, any gain or loss realized but not recognized by Company B pursuant to § 1031 on the transfer of Relinquished Property will not generate earnings and profits (or a deficit in earnings and profits) of Company B under § 964 for the year in which such gain or loss is realized but not recognized. See §§ 312(f)(1), 1.312-7(b)(1), and 1.964-1.

DISCLAIMERS

Except as provided above, no opinion is expressed as to the Federal tax treatment of the above transaction under any other provisions of the Internal Revenue Code and the Income Tax Regulations that may be applicable, including § 482, or under any other general principles of Federal income taxation. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, nor effects resulting from, the transaction that are not specifically covered by the above ruling.

This letter is not a ruling that the above transaction satisfies all of the requirements for nonrecognition treatment under § 1031 and the regulations thereunder. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination. No opinion is expressed as to whether the accommodators used in this transaction are disqualified persons as defined in § 1.1031(k)-1(k), as that would constitute essentially a factual determination.

This ruling is directed only to Taxpayer. Section 6110 (k)(3) provides that it may not be cited as precedent. Pursuant to the Power of Attorney submitted by Taxpayer, a copy of this letter will be sent to Taxpayer's authorized representatives.

Sincerely,

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Amy Pfalzgraf
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Income Tax and Accounting)