IRS Letter Rulings and TAMs (1954-1997), UIL No. 168.00-00 Amortization of emergency facilities, Letter Ruling 8312023, (Dec. 16, 1982), Internal Revenue Service, (Dec. 16, 1982)

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Letter Ruling 8312023, December 16, 1982

Uniform Issue List Information:

UIL No. 0168.00-00

Amortization of emergency facilities

This is in response to a letter dated October 2, 1982, submitted on your behalf, requesting a ruling on the federal income tax consequences of a proposed transaction. The facts of the transaction are represented by Taxpayer to be as follows:

Taxpayer is a State X corporation primarily engaged in the business of leasing aircraft to Corp M to other businesses in which A has an interest, and to other persons and companies. A, an individual, is the sole shareholder of Taxpayer and the principal shareholder of Corp M.

In 1977, Taxpayer acquired a contract from Corp P to purchase an aircraft from Corp O. The original contract, entered into on September 10, 1976, was between Corp O, the manufacturer of the aircraft, and Corp P. The purchase price was in excess of $4,375,000 in * * * dollars.

The aircraft that was delivered by Corp O is known as “green aircraft”, a term of art that describes an unfinished aircraft, or a shell. The aircraft was delivered to Taxpayer on March 18, 1982. At the time, it had only three seats, two for the pilots and one for the Federal Aviation Agency inspector. The aircraft was not painted, nor did it have any insulation, except around the cockpit. The interior was completely unfinished, except for a portable toilet. The floor was also unfinished. Except for basic emergency equipment, the aircraft lacked long range navigation and communication equipment. Its safety systems were inoperative as were its engine thrust reversers.

On June 3, 1980, Taxpayer entered into a contract with Corp Q for the completion of the aircraft. As indicated above, the “green aircraft” was delivered to Taxpayer in March, 1982. The aircraft was immediately flown to Corp Q’s construction and service center for construction and completion of the interior of the aircraft. The total cost of this work is approximately $1 million. Under the contract with Taxpayer, Corp Q will construct or install computer, communication, and navigation systems, various cockpit equipment as well as the bar, lavatories, galley & storage units. In addition, Corp Q will install chairs and tables in the main cabin and the necessary lavatory equipment.

Taxpayer indicates that even prior to the delivery of the aircraft, Corp Q had constructed subassemblies and interior structural fabrication and had commenced building mock-ups of the interior and avionics installation. By June 27, 1982, approximately 178 man hours had been expended by Corp Q on interior structural work and another 84 man hours were spent in fabricating sheet metal for avionics installation. Taxpayer states that every phase of construction of the aircraft had substantial work performed except for the actual installation of furniture and some equipment.

Taxpayer expects the aircraft to be completed prior to January 1, 1983. As soon as the work is completed, Taxpayer intends to execute a sale-leaseback agreement pursuant to section 168(f)(8) of the Code with Corp R as Lessor.

Section 168(f)(8)(A) of the Internal Revenue Code allows parties to an agreement with respect to qualified leased property, to characterize the agreement as a lease and elect to have the provisions of section 168(f)(8) apply provided the requirements of subparagraph (B) are met. If the requirements of subparagraph (B) are met, the agreement shall be treated as a lease and the lessor shall be treated as the owner of the property and the lessee shall be treated as the lessee of the property.

The requirements of section 168(f)(8)(B) of the Code are met if--(i) the lessor is a corporation (other than an electing small business corporation within the meaning of section 1371(b)) or a personal holding company (within the meaning of section 542(a)); (ii) the lessor’s minimum investment at the time the property is first

placed in service under the lease and at all times during the lease term is not less than 10 percent of the adjusted basis of the property; and (iii) the term of the lease does not exceed the greater of 120 percent of the present class life of the property, or the period equal to the recovery period determined with respect to such property under subsection (i)(2).

Section 208(a) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) imposes restrictions on taxpayers that enter into safe harbor lease transactions after July 1, 1982. In part, a lessor that enters into a safe harbor lease transaction after July 1, 1982 may not reduce its tax liability by more than 50 percent. In addition, the recovery periods of 3 year, 5 year, and 10 year property are extended to 5 years, 8 years and 15 years respectively. Furthermore, the investment tax credit is allowed only over a five year period.

Section 208(b) of TEFRA imposes additional requirements in order to qualify a transaction as a lease for purposes of accelerated cost recovery. Part of the restrictions require that the cost basis of all safe harbor lease property which is placed in service during any calendar year, and with respect to which the taxpayer is a lessee, shall not exceed an amount equal to the 45 percent of the cost basis of the taxpayer's qualified base property placed in service during such calendar year.

Section 208(d)(1) of TEFRA states that except as otherwise provided in this subsection, the amendments made by subsections (a) and (b) of this section shall apply to agreements entered into after July 1, 1982, or to property placed in service after July 1, 1982.

Section 208(d)(2)(A) of TEFRA states that the amendments made by subsections (a) and (b) shall not apply to transitional safe harbor lease property.

Section 208(d)(3)(A) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) describes, in part, the term "transitional safe harbor lease property. Property will be transitional safe harbor lease property if such property is placed in service before January 1, 1983 if--

(i) with respect to such property a binding contract to acquire or construct such property was entered into by the lessee after December 31, 1980 and before July 2, 1982, or

(ii) such property was acquired by the lessee or construction of such property was commenced by or for the lessee after December 31, 1980 and before July 2, 1982.

Section 5c.168(f)(8)-6(a)(2)(i) of the Temporary Regulations provides that where the leased property is purchased, directly or indirectly, by the lessor from the lessee, the property will not be qualified leased property unless the property was (or would have been) new section 38 property of the lessee and was purchased and leased no later than 3 months after the date the property was placed in service by the lessee.

Section 5c.168(f)(8)-6(b)(2)(i) of the Temporary Regulations provides that property shall be considered as placed in service at the time the property is placed in a condition or state of readiness and availability for a specifically assigned function.

The primary question to be considered is whether the green aircraft and the improvements will constitute "transitional safe harbor lease property" as defined in section 208(d)(3) of TEFRA. Unless property qualifies as transitional safe harbor lease property, the restrictive provisions of subsections (a) and (b) of section 208 of TEFRA apply. In order to qualify as transitional safe harbor lease property, the property must meet two basic requirements, it must be placed in service prior to January 1, 1983 and it must come within the window period. Taxpayer has indicated that it intends to enter into a sale-leaseback transaction before January 1, 1983. The window period extends from December 31, 1980 to July 2, 1982. If, during that period, Taxpayer has either

(i) entered into a binding contract to acquire the property;

(ii) entered into a binding contract to construct the property.

(iii) acquired the property, or

(iv) commenced construction of the property or had construction commenced by or for it.

the property will be eligible for safe harbor lease treatment as defined under the Economic Recovery Tax Act of 1981.

As stated in A-1 of section 5f.168(f)(8)-1 of the Temporary Regulations, the four tests listed above are stated in the alternative, and, accordingly, property may be eligible for pre-TEFRA safe harbor leasing if any one of

the tests are satisfied. In the instant case, Taxpayer acquired the green aircraft in March, 1982, well within the time frame prescribed by section 208(d)(3)(A) of TEFRA. Consequently, the aircraft shell should be considered transitional safe harbor lease property.

The interior of the aircraft, an essential element of the aircraft, was not acquired during the window period, nor was a contract to construct the interior entered into during the window period. The contract with Corp Q was signed on June 3, 1980. However, Taxpayer has demonstrated that a substantial amount of construction had commenced on all aspects of the interior of the aircraft as well as the other equipment needed to certify it for FAA approval. Consequently, the improvements should be considered transitional safe harbor lease property.

With respect to the issue of when the aircraft, together with improvements, is placed in service, we look to section 5c.168(f)(8)-6(b)(2)(i) of the Temporary Regulations. This section provides that property shall be considered as placed in service at the time the property is placed in a condition or state of readiness and availability for a specifically assigned function. Although the green aircraft could actually fly in March, 1982, its ability to serve as a corporate jet, capable of transporting passengers will not come into existence until the interior of the aircraft has been completed. Consequently, the aircraft will not be considered placed in service until Corp Q has completed its work on the aircraft's interior.

According, based on the above facts and representations, it is held for federal income tax purposes that:

1. The "green" aircraft acquired from Corp O constitutes transitional safe harbor lease property" as defined in Section 208(d)(3) of TEFRA.

2. The improvements to the Aircraft made pursuant to the contract between Taxpayer and Corp Q constitutes "transitional safe harbor lease property" as defined in Section 208(d)(3) of TEFRA.

3. The aircraft will be deemed ready for use and placed in service by Taxpayer only when the improvements to the "green" aircraft are completed by Corp Q pursuant to Section 5c.168(f)(8)-6(b)(2)(i) of the Temporary Regulations.

4. The provisions of Subsections (a) and (b) of Section 208 of TEFRA are not applicable to the aircraft (Section 208(d)(2)(A) of TEFRA).

5. So long as the provisions of Section 168(f)(8) of the Code, as amended prior to the enactment of TEFRA, are satisfied, the Lease shall be treated as a lease entered into by Taxpayer and the Lessor in the ordinary course of carrying on their respective trades or business, the Lessor shall be treated as the owner of the Aircraft and Taxpayer shall be treated as the lessee of the Aircraft (Section 208(d)(2) of TEFRA and Section 168(f)(8) of the Code).

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

In accordance with the power of attorney on file, a copy of this letter is being sent to your legal representative. Please include a copy of this letter with your tax return in the year the transaction is consummated.

(Signed) John L. Crawford

Chief, Corporation Tax Branch