M e m o r a n d u m

To: Santa Barbara – Auditing (EMR)   Date: January 14, 1977

From: Headquarters – Tax Counsel (HLC)

Subject: P--- Rentals   SR --- XX XXXXXX

This is in reply to your memorandum dated January 4, 1977, in which you refer to us questions from subject taxpayer regarding his transactions.
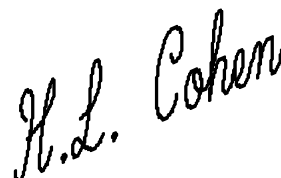
Taxpayer is in the equipment rental business. Some of his equipment was acquired tax-free, and he now wishes to convert it to tax-paid status. He proposes to sell the equipment to a non-related organization at fair market value and then to reacquire all or most of it paying tax on the reacquisition price. His intent is to avoid tax on rental receipts.

It is our opinion that taxpayer's plan would not be effective to avoid tax on rental payments. The transaction described would be a sham if there were a written or oral understanding with the other organization that taxpayer would reacquire the equipment. We would look to the substance of the transaction rather than the form. The substance would be that taxpayer would be making an election to pay tax on the purchase price of rental equipment after the time at which an election is permitted. Further, there would be no satisfactory method for us to verify what the market value of the equipment actually was.

Taxpayer could accomplish his aim by establishing a separate corporation. A separate business not a corporation would not suffice because taxpayer, rather than a different entity would still be the owner.

Taxpayer also proposes to pay tax reimbursement at the time of purchase on all tools, supplies and equipment held for resale. He would then claim tax credit at the time these items are resold. It is not clear from taxpayer's letter what problem he is attempting to solve. It is, of course, permissible for a taxpayer to purchase goods tax-paid and then to claim a credit for tax-paid purchases resold when the goods are sold provided no use, such as rental, is made of the goods prior to resale

HLC:jw

H.L. Cohen