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Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Docket ID: IRS-2018-0018, Additional First Year Depreciation Deduction (REG-104397-18)

This letter provides comments from the Equipment Leasing and Finance Association (ELFA) in response to the notice of proposed rulemaking issued by the Internal Revenue Service and the Department of the Treasury ("Treasury") in the Federal Register on August 8, 2018 regarding the "Additional First Year Depreciation Deduction."

ELFA appreciates the Treasury Department and Internal Revenue Service's recognition in the proposed rule that, in most cases, allows for lessees purchasing equipment from the lessor at the end of a true lease to be eligible for the additional first year depreciation deduction. ELFA has long believed that property used by an owner-operator should be treated no differently than property that is leased, even when it is being disposed of by the taxpayer, and appreciates that the proposed rules accommodate this treatment in most cases for leased equipment.

BACKGROUND ON ELFA

ELFA is the trade association representing financial services companies and manufacturers in the $1 trillion U.S. equipment finance sector. Equipment finance not only contributes to businesses' success, but to U.S. economic growth, manufacturing and jobs. Seventy-eight percent of U.S. companies use some form of financing when acquiring equipment, including loans, leases, and lines of credit (excluding credit cards). Each year American businesses, nonprofits, and government agencies invest over $1.508 trillion in capital goods and software (excluding real estate). Some 68%, or $1.034 trillion, is financed through loans, leases, and other financial instruments. America's equipment finance companies are the source of such financing, providing access to capital.

ELFA represents more than 575 member companies, including many of the nation's largest financial services companies and manufacturers and their associated service providers, as well as regional and community banks and independent, medium, and small finance companies throughout the country. ELFA member companies finance the acquisition of all types of capital equipment and software, including agricultural equipment; IT equipment and software; aircraft; manufacturing and mining machinery; rail cars and rolling stock; vessels and containers; trucks and transportation equipment; construction and off-road equipment; business, retail, and office equipment; and medical technology and equipment. The customers of ELFA members range from Fortune 100 companies to small and medium sized enterprises to governments and nonprofits.

ELFA represents virtually all sectors of the equipment finance market and its members see virtually every type of equipment financing transaction conducted in the United States and every type of funding available to providers of equipment finance. ELFA members who are service providers to the equipment finance industry (such as lawyers, accountants, trustees and vendors) have a unique vantage point of seeing scores of financial transactions from initial concept to final payout and from the perspective of both the borrower/issuer and lender/investor/funding source. ELFA truly is at the heart of equipment finance in the United States and our member companies provide lease, debt, and equity funding to companies of all sizes.

SALE-LEASEBACKS

Sale-leasebacks are a common commercial transaction that have been executed for decades for a variety of reasons.

Under the proposed rules, ELFA believes that Section f(1) of the rule as drafted would preclude certain taxpayers who enter into future sale-leaseback agreements as lessees from utilizing bonus depreciation at the then applicable percentage should they purchase the leased equipment from the lessor. This is because such a taxpayer may have placed the equipment in service for a short period of time prior to executing the sale-leaseback (i.e., it would have had a "depreciable interest" in the equipment) and would be precluded from claiming bonus depreciation upon re-acquiring the equipment from the lessor. There are a variety of reasons that this scenario could arise.

In the first situation, the taxpayer may acquire five similar assets from different suppliers, placing them into service as they become available for operational reasons, then shortly thereafter enter into a sale-leaseback with a financial institution for all five assets that it has placed in service. This sale-leaseback would entail the taxpayer selling all five assets to the financial institution and then leasing them back for a period of time making periodic rent payments. As we read the draft rule, if for instance at the end of the lease, the taxpayer wished to exercise a purchase option at the end of a three-year lease, under Section f(1), it would not be eligible for bonus depreciation with respect to such assets because the taxpayer had a depreciable interest in the assets prior to executing the sale-leaseback. However, the taxpayer would be eligible for bonus depreciation if it

purchased different assets, that served the same purpose, from a seller who was not a party to the original lease.

In the second situation, the taxpayer may purchase five assets from one supplier, which are going to be delivered over a period of time, say two months. For operational reasons, the taxpayer will begin using the first delivered asset when it is delivered and enter into the sale-leaseback with respect to all five assets when the fifth asset is delivered. Again, if the taxpayer wished to purchase the leased assets from the lessor, it would not be eligible for bonus deprecation with respect to the assets, but the taxpayer would be able to use bonus depreciation if it purchased different assets, that served the same purpose, from a seller who was not a party to the original lease. This seems to incentivize transactions that are not economically efficient.

Under tax law prior to December of 2017, the tax payer would never have depreciated these assets as long as the placement into service and the sale of the assets occurred in the same taxable year. Under current law, the taxpayer would also not depreciate the asset during the year that they acquired the asset because it sold the asset in the same year. We believe that if a taxpayer purchases assets from a lessor leasing the assets pursuant to a true lease, it should be eligible for bonus depreciation provided it never depreciated the asset in a previous tax year. To do otherwise creates an uneconomical situation where a taxpayer is better off returning equipment to a lessor and purchasing identical, save for the serial numbers, equipment from a third party.

It was for these reasons that ELFA recommends that the Treasury Department utilize a never-having-depreciated test when determining whether a taxpayer met the first use test. It is important to note that ELFA does not believe that taxpayers should be eligible for bonus deprecation in situations where they have depreciated that asset in a previous tax year. We believe that there are two possible solutions to this situation. The first would be to utilize a never having depreciated test. The second would be to add an additional exemption to f(1) allowing the additional first year depreciation in the case of a lessee exercising a purchase option at the end of the leaseback portion of a sale-leaseback assuming:

- The original sale-leaseback was between unrelated parties, and
- The leaseback was commenced within the same tax year of the asset first being placed in service by the seller/lessee.

Congress intended the provisions allowing for additional first year depreciation to promote capital formation for both new **and used** equipment. Nowhere in the legislative history is there any sign of Congressional intent to treat assets that have been leased any differently than other used assets. ELFA believes that the solutions we suggest to resolve these issues relating to sale-leasebacks provide no opportunity for abusive churning of assets. However, absent their adoption ELFA believes that there will be perverse economic incentives in place. These incentives potentially take lease purchase option

decisions that would be economically and practically efficient and make them uneconomic and impractical when compared to acquiring identical equipment (save for the serial numbers) from a third party.

SALE-LEASEBACKS PRIOR TO PASSAGE OF THE TAX CUTS AND JOBS ACT

From a historical perspective, since 2008, under prior law a "3-month sale-leaseback rule" had been in place to facilitate the efficiency of capital formation for lease financing of property for sale-leasebacks.

Under those rules, property sold and leased back within three months of being originally placed in service qualified for the special depreciation allowances often described as "bonus depreciation." In those cases, provided the lessee did not change, then the property was treated as originally placed in service by the taxpayer (the lessor) no earlier than the date of the last sale. For lessees affording themselves of this process, no tax depreciation was claimed on those assets included in the sale leasebacks executed within the three months. Lessees and lessors have been equally meticulous to assure compliance with this rule by carefully examining documents to ensure the asset purchases met the 3-month rule.

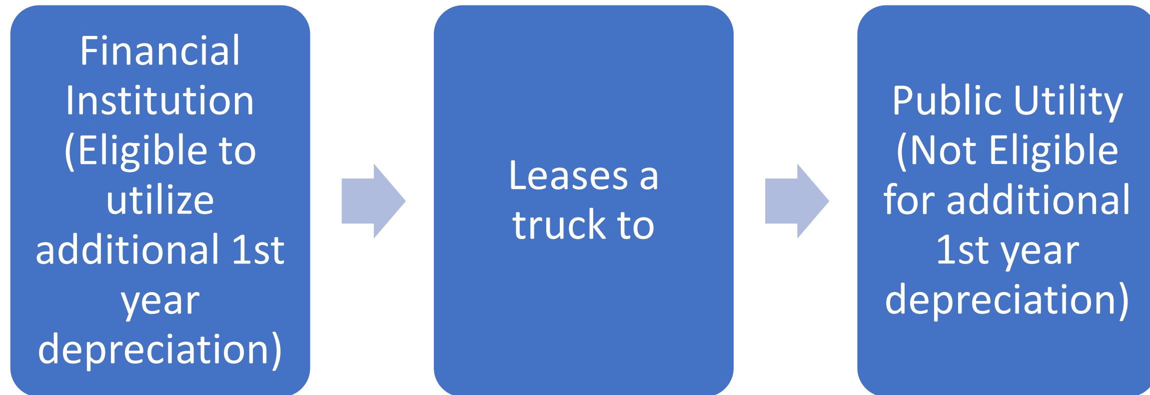
These rules recognized that efficient capital markets, including the leasing market, required administrative processes that are reasonable and make sense. Since 2008, thousands of assets have been leased using this sale-leaseback rule. Many of those leases were syndicated transactions which efficiently distributed large numbers of assets to multiple lessor investors. Many thousands of assets remain under leases originated prior to passage of the TCJA and were leased in compliance with the rules in place at the time.

ELFA believes that the problems alluded to in the previous section also apply to these existing leases. We believe that the solutions presented in that section would also solve these problems for existing leases.

ADDITIONAL GUIDANCE REQUEST LEASING TO TRADES OR BUSINESSES THAT ARE EXEMPTED FROM ADDITIONAL FIRST YEAR DEPRECIATION

There remains at least one item that appears to be unaddressed by the proposed regulations. IRC §168(k)(9) excludes from the definition of qualified property for additional first year depreciation eligibility any equipment used in several specific trades or businesses – including, but not limited to public utilities, farm businesses, and entities utilizing floor plan financing. The exclusion is by reference to IRC §163(j)(7)(A) which defines those trades or businesses which are exempt from the new net interest expense limitations under §163.

ELFA requests guidance regarding whether or not certain assets qualify for additional first year depreciation when they are leased by an entity that qualifies for additional first year depreciation to an entity that is not eligible for additional first year depreciation. The following chart is illustrative:



Public utilities are frequent users of lease financing, both for large assets such as electric generation stations, but also much more commonly for shorter lived assets such as service trucks and boom trucks. Farmers are frequent users of lease financing, for both financial reasons such as cash-flow, and for practical reasons, such as avoiding equipment obsolescence. Companies that utilize floor plan financing such as auto dealerships and construction equipment dealerships oftentimes may lease equipment they require to operate those businesses, such as computers, copiers, phone systems, and tools.

Several questions present themselves in these examples. Is a service truck actually used in the regulated trade or business of selling electricity? Is a truck owned by a financial institution (and so used in our business of equipment financing) but leased to a public utility considered "public utility property" or not? Is a combine owned by the original equipment manufacturer's captive finance arm and leased to a farmer, used in the trade or business of an electing farmer? Are copiers owned by an independent lessor, but used at an auto dealer who utilizes floor plan financing primarily used in that trade or business? Certainly, the taxpayer claiming bonus in each of these cases of such a lease (the lessor) is eligible, but the status of the property leased to an ineligible entity is unclear.

Currently, many lessees and lessors are uncertain about the bonus eligibility of property leased to an exempted entity, leading many market participants to adopt the conservative position absent clear guidance, which is a potentially inefficient financing outcome for all parties. Excluding bonus depreciation from the true lease pricing model has the impact of increasing the cost of the lease to the lessee. We do not believe an intended consequence of the rule was to increase the lease cost of these generic assets to these types of entities which play a vital role in our economy.

ELFA would note that the exclusion from 100% bonus eligibility in the direct hands of a public utility was a clear trade-off for exclusion from the net interest expense limitations; however, lessors in all of these situations are subject to that net interest expense limitation, so the taxpayer claiming the 100% bonus would be subject to that related limitation.

Additionally, in many cases lessors are often not privy to that level of detailed information about the potential lessee. For instance, a lessor would not know or be expected to know whether an auto or construction equipment dealership utilizes floor financing or not. Similarly, many utilities may well have multiple different legal entities which individually lease assets such as construction equipment or bucket trucks. To expect a lessor to have this level of information about the operations of the entity leasing this type of asset seems administratively onerous in many cases.

Accordingly, ELFA believes that guidance is warranted making it clear that the owner of an asset, the lessor in our member companies' cases, is eligible for additional first year depreciation absent a reason that the owner of the asset, the lessor, is otherwise exempted.

RECORD KEEPING RULES

In the Supplementary Information preamble (Section 3(B)(ii) on page 13) to the new draft Regulations related to IRC 168(k), the Treasury Department and IRS request input, including tenor and rationale, on a potential safe harbor related to the maximum 'look back' period for assessing whether a taxpayer previously had a depreciable interest in a given property. This request acknowledges that the 'not previously used by' standard (IRC §168(k)(2)(E)(ii)(I)) with respect to 100% bonus depreciation eligibility creates an implicit obligation on the taxpayer to indefinitely track all prior asset ownership in order to assess the proper depreciation for any piece of used equipment purchased.

Given that the purpose of this 'not previously used by' standard is presumably to prevent asset churning by taxpayers, which implicitly presumes a very quick turn-around period so that use / control of the asset can be maintained, it seems that a 'look back' period of three years (inclusive of current tax year) is more than sufficient to prevent such churning abuse while also eliminating the need to maintain indefinite records on prior asset ownership in order to remain tax compliant. A safe harbor allowing taxpayers to assess only whether they or an affiliate had a prior depreciable interest in a specific asset within the last three tax years (inclusive of current tax year) will prevent churning abuse, while also allowing taxpayers to undertake only a reasonable amount of tax records due diligence in order to determine the proper depreciation treatment when acquiring used property. Having a prior depreciable interest in property that pre-dates the preceding three tax years (inclusive of current tax year), but where the taxpayer has not had more recent ownership of the asset, seems economically irrelevant to any current taxpayer

decision to acquire the property now, and so should be irrelevant to the proper tax depreciation treatment.

The IRS is correct to recognize that assets can change hands multiple times through their useful life, and that many taxpayers, particularly financial institutions engaged in active leasing businesses, may therefore have occasion to acquire, sell, and re-acquire a specific asset for valid commercial reasons having nothing to do with churning. By limiting the testing period for prior ownership to a reasonable term (three tax years is proposed), a simplifying safe harbor will ensure that active leasing companies are not disadvantaged in providing competitive financing on used equipment for customers in the highly active market for used equipment financing while also preventing any undesirable asset churning activity.

Thank you for the opportunity to comment on this important matter. ELFA has enjoyed a collegial working relationship with the Treasury Department and the Internal Revenue Service during this regulatory process and compliments the team working on these regulations for their diligent and thoughtful efforts. Should you have any questions regarding this submission please contact Andy Fishburn, ELFA's Vice President of Federal Government Relations at afishburn@elfaonline.org. We look forward to working with you as this regulatory process moves forward.

Respectfully submitted,

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President and CEO