

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B06  
PLR-149182-04

Date:

September 19, 2005

Re:

Legend

Facility =

Taxpayer =

State X =

A =

State Y =

Date1 =

B =

Date 2 =

C =

D =

E =

F =

\$G =

\$H =

I% =

State Z =

LMSB Official =

Dear

This letter responds to a letter dated September 15, 2004, requesting a ruling that a Facility, in which Taxpayer has an interest, constitutes "qualified Indian reservation property" within the meaning of section 168(j) of the Internal Revenue Code.

## FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is a State X limited partnership and A is a State Y corporation. Taxpayer and A are engaged in the equipment leasing and asset finance business. On Date1, upon completion of the Facility, Taxpayer and A jointly acquired the Facility, and leased the Facility to an unrelated party in the B business. The Facility was placed in service by Taxpayer and A on or before Date 2. The Facility includes buildings and production machinery and equipment. Legal title to the Facility is held by C in order to facilitate the construction financing of the Facility and to qualify the Facility for exemption from local property taxes. C was formed specifically for the financing of the Facility and has no other assets, liabilities, or activities. C is leasing the Facility to Taxpayer and A for a term of approximately D years from Date1 (consisting of a base term of E years plus E renewal terms of E-years each). Taxpayer and A paid \$G to C on Date1 to acquire their interests in the Facility and have no further rent obligations to C (other than renewal rents of \$H each per E-year renewal term). Taxpayer and A own the Facility for Federal income tax purposes.

The Facility is located within an Indian reservation within the meaning of section 168(j)(6) of the Code. The Facility is not used or located outside an Indian reservation on a regular basis within the meaning of section 168(j)(4)(A)(ii) and was not acquired (directly or indirectly) by Taxpayer and A from a person who is related to either Taxpayer or A within the meaning of section 168(j)(4)(A)(iii). Further, the Facility (and each portion thereof) is not property placed in service for purposes of conducting or housing class I, II, or III gaming within the meaning of section 168(j)(4)(A)(iv), and the Facility is not subject to the alternative depreciation system under section 168(g). At least I% of the fair market value of the Facility consists of real property within the meaning of State Z property law.

## RULING REQUESTED

The Facility constitutes “qualified Indian reservation property” within the meaning of section 168(j).

## LAW AND ANALYSIS

The depreciation deduction provided by section 167(a) of the Code for tangible property placed in service after 1986 generally is determined under section 168, which is the modified accelerated cost recovery system (MACRS). Section 168 prescribes for a general depreciation system in section 168(a) and an alternative depreciation system in section 168(g). Under the general depreciation system, the depreciation deductions are determined by using the applicable depreciation method under section 168(b), the applicable recovery period under section 168(c), and the applicable convention under section 168(d).

Section 13321 of the Omnibus Budget Reconciliation Act of 1993 amended section 168 of the Code by section 168(j) to establish an Indian reservation-based, federal tax incentive in the form of accelerated depreciation for qualified Indian reservation property. Section 168(j)(1) provides that for purposes of section 168(a), the applicable recovery period for qualified Indian reservation property is determined in accordance with the table contained in section 168(j)(2) in lieu of the table contained in section 168(c). The table in section 168(j)(2) provides recovery periods that are shorter than the recovery periods provided under the table in section 168(c). Section 168(j) is effective for property placed in service after December 31, 1993.

Only “qualified Indian reservation property” is eligible to use the recovery periods provided in section 168(j)(2) of the Code. Under section 168(j)(4)(A), the term “qualified Indian reservation property” generally means property which is described in the table in section 168(j)(2) and which is --

- (i) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation,
- (ii) not used or located outside the Indian reservation on a regular basis,
- (iii) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer (within the meaning of section 465(b)(3)(C)), and
- (iv) not property (or any portion thereof) placed in service for purposes of conducting or housing class I, II, or III gaming (as defined in section 4 of the Indian Regulatory Act (25 U.S.C. 2703)).

Section 168(j)(4)(B) of the Code provides that the term “qualified Indian reservation property” does not include any property to which the alternative depreciation system under section 168(g) applies, determined (i) without regard to section 168(g)(7) (relating to election to use alternative depreciation system), and (ii) after the application of section 280F(b) (relating to listed property with limited business use).

Section 168(j)(5) of the Code provides that, for purposes of section 168(j), the rental to others of real property located within an Indian reservation shall be treated as the active conduct of a trade or business within an Indian reservation.

The term “Indian reservation” is defined in section 168(j)(6) of the Code as meaning a reservation, as defined in either section 3(d) of the Indian Financing Act of 1974, (25 U.S.C. § 1452(d)), or section 4(10) of the Indian Child Welfare Act of 1978, (25 U.S.C. § 1903(10)).

Under section 168(j)(5) of the Code, the rental to others of real property located within an Indian reservation is treated as the active conduct of a trade or business within

an Indian reservation. Under section 168(j)(4)(A), otherwise qualifying property under section 168(j)(4)(A)(ii)-(iv) constitutes qualified Indian reservation property if the property is used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation. See section 168(j)(4)(A)(i). The Facility is not property subject to the alternative depreciation system under section 168(g)

In Taxpayer's current situation, the entire Facility is leased to an unrelated third party, and over I% of the fair market value of the Facility constitutes real property under applicable State Z law. Taxpayer characterizes Taxpayer's and A's lease of the Facility to the unrelated party in the B business as a triple net lease of property (under which the lessor does not provide services to the lessee, with the lessee being fully responsible for operating, maintaining, insuring and otherwise dealing with the leased property). Taxpayer notes that a triple net lease of property, such as the lease of the Facility, does not put the lessor in an active trade or business. Taxpayer's position is that the entire Facility should constitute qualified Indian reservation property within the meaning of section 168(j) of the Code.

Under the general depreciation system of section 168 of the Code, the depreciation deductions are determined by using the applicable depreciation method under section 168(b), the applicable recovery period under section 168(c), and the applicable convention under section 168(d). For example, in the case of nonresidential real property under section 168(e)(2)(B), the applicable depreciation method generally is the straight line method and the applicable convention is the mid-month convention. Under section 168(c) of the Code, the recovery period for nonresidential real property is 39 years and the recovery period for such property, which is qualified Indian reservation property, is 22 years.

Section 168(e)(2)(B) of the Code provides that the term "nonresidential real property" means section 1250 property which is not (i) residential rental property, or (ii) property with a class life of less than 27.5 years. Section 168(i)(12) provides that the terms "section 1245 property" and "section 1250 property" have the meanings given such terms by sections 1245(a)(3) and 1250(c), respectively.

Under section 1250(c) of the Code, the term "section 1250 property" means any real property (other than section 1245 property, as defined in section 1245(a)(3)), which is or has been property of a character subject to the allowance for depreciation provided in section 167. Section 1.1250-1(e)(3)(i) of the Income Tax Regulations defines the term "real property" as meaning any property which is not personal property within the meaning of section 1.1245-3(b).

Section 1.1245-3(b) of the regulations defines the term "personal property" as meaning (1) tangible personal property (as defined in section 1.48-1(c), relating to the definition of "section 38 property" for purposes of the investment credit), and (2) intangible personal property. Section 1.48-1(a) provides, in general, that property which

qualifies for the investment tax credit is known as “section 38 property”. Section 1.48-1(a) lists tangible personal property as a category of section 38 property.

Section 1.48-1(c) of the regulations provides that local law shall not be controlling for purposes of determining whether property is or is not “tangible” or “personal” and the fact that under local law property is held to be personal property or tangible property shall not be controlling. Further, section 1.48-1(c) provides that property may be personal property for purposes of the investment credit even though under local law the property is considered to be a fixture and therefore real property. For purposes of section 1.48-1, the term “tangible personal property” means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures).

Otherwise qualifying property under section 168(j)(4)(A)(ii)-(iv) of the Code constitutes qualified Indian reservation property, for purposes of section 168(j)(4)(A), if it is used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation. See section 168(j)(4)(A)(i). Taxpayer characterizes the lease of the Facility to the unrelated party as a triple net lease of property. The triple net lease of property is described as a lease under which the lessor does not provide services to the lessee and the lessee is fully responsible for operating, maintaining, insuring, and otherwise dealing with the leased property. Taxpayer notes that a triple net lease of property, such as the lease of the Facility, does not put the lessor in an active trade or business. Under section 168(j)(5) of the Code, the rental to others of real property located within an Indian reservation is treated as the active conduct of a trade or business within an Indian reservation.

Taxpayer’s position is based on applying State Z property law to determine whether the Facility constitutes real property for purposes of section 168(j)(5) of the Code. However, for purposes of section 168(j)(5), the test for determining whether an item of property is real property is not based on local law (i.e., State Z property law) but instead, relies on the use of the term “real property” in section 168(e)(2)(B). Section 168(e)(2)(B) and section 168(i)(12) show that the definition of real property in section 168 is based on the rules for investment credit under former section 48 of prior law.<sup>1</sup> See section 1250(c) and sections 1.1245-3(b), 1.1250-1(e)(3), and 1.48-1(c) of the regulations. Section 1.48-1(a) of the regulations provides that property which qualifies for the investment tax credit is known as “section 38 property”. Tangible personal

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<sup>1</sup> The Tax Reform Act of 1986 (P.L. 99-514) in general repealed the regular investment credit for property placed in service after December 31, 1985. In Hospital Corp. of America and Subsidiaries v. Commissioner, 109 T.C. 21 (1997), acq. in result only, 1999-2 CB. 314, the Tax Court addressed the issue of the applicability of tests developed under pre-1986 regular investment credit (ITC) rules to section 1245, which specifically adopted the regulations under former section 48 defining “section 38 property” to determine whether property was tangible personal property for purposes of MACRS. The court concluded that the tests developed under prior law to ascertain whether property constituted tangible property for purposes of investment tax credit are applicable to decide whether the property constitutes tangible personal property for purposes of MACRS.

property, a category of “section 38 property,” is defined in section 1.48-1(c). Section 1.48-1(c) provides that local law shall not be controlling for purposes of determining whether property is or is not “tangible” or “personal.” Further, section 1.48-1(c) provides that property may be personal property for purposes of the investment credit even though under local law the property is considered to be a fixture and therefore real property. Accordingly, it follows that the determination of whether the entire Facility constitutes real property for purposes of section 168(j)(5) is not based on State Z property law but on the determination of whether property is real property under the principles of section 1245, section 1250, and former section 48.

## CONCLUSIONS

Based solely on the representations and the relevant law and analysis set forth above, we conclude that:

(1) the determination of whether the Facility or portions thereof constitute real property for purposes of section 168(j)(5) of the Code is not based on State Z property law (i.e., local law), but is based on the meaning of real property for purposes of section 168 and therefore is based on section 1245, section 1250, and former section 48;

(2) in view of Taxpayer’s specific representations that the qualifying requirements of section 168(j)(4)(A)(ii)-(iv) have been met and that the Facility is not subject to the alternative depreciation system under section 168(g), those portions of the Facility that are real property for purposes of section 168(j)(5) constitute qualified Indian reservation property under section 168(j) so long as the Facility continues to meet the section 168(j)(4)(A)(i) requirement; and

(3) those portions of the Facility that are not real property for purposes of section 168(j)(5) do not meet the section 168(j)(4)(A)(i) requirement and do not constitute qualified Indian reservation property under section 168(j).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the transaction described above under any other provisions of the Code.

This letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(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 with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter to the LMSB Official.

Sincerely,

Charles B. Ramsey

Charles B. Ramsey  
Chief, Branch 6  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
copy of this letter  
copy for section 6110 purposes