Revenue Ruling 55-541

Where a corporation manufacturing office equipment leases certain items of such equipment to another corporation, the lease being in reality a transfer of equitable ownership of the equipment to the lessee, the sum of the payments properly allocable to the sale price constitutes proceeds from sale of the equipment by the manufacturing corporation. Such payments made or to be made by the lessee corporation constitute capital expenditures, recoverable through depreciation deductions over the estimated useful life of the equipment.

Advice has been requested as to the proper treatment for Federal income tax purposes of the following described transaction.

Corporation *P*, a lease broker, solicited from corporation *M* an order to lease certain office equipment manufactured by corporation *N* and having a manufacturer's list price of 100*x* dollars. Attached to the order was a "Personal Property Lease Agreement" which was entered into by corporation *M* and corporation *N*.

Under the order and the agreement, corporation *N* is to furnish the desired equipment to corporation *M* for a period of 36 months for a total consideration of 116*x* dollars payable in equal monthly installments. The agreement and the order both provide that the agreement can be renewed for 10 years, in one year renewals for 1*x* dollars per year. Corporation *M* is to pay as additional "rental" all taxes on the property, insurance, and the cost of keeping the equipment in good repair and working order.

Corporation *P* stated is its letter soliciting the order from corporation *M* that after the base lease period the "lessee" continues to use the equipment at one percent of its original invoice value, and, at all times during the term of the lease or use, the "lessee" has full trading privileges which would normally exist were he the owner of the property, thus giving him all the benefits of ownership without any of the hazards of depreciation or the resultant loss of working capital. Corporation *M* was also advised that the " lease" would be assigned to a bank or an insurance company and that all payments thereunder would be made to the assignee.

The agreement contains no provision whereby corporation *M* may acquire legal title to the equipment. It does, however, contain a provision for the return of the equipment to the "lessor" upon the expiration or termination of the lease.

In order to determine the proper method of reporting income and deductions for corporation *N* resulting from this transaction and the reporting of deductions for corporation *M*, it is necessary to ascertain whether the agreement is, in fact, a lease, or whether it transfers the equitable title of the equipment to corporation *M*.

The absence of reference in an agreement to the transfer of legal title to the property to the user, while indicative of a lease, does not of itself classify the agreement as a lease. In all cases the entire agreement must be studied to ascertain the true intent of the parties.

Equipment of the type being acquired by corporation *M* has an estimated useful life of from 10 to 15 years. The agreement permits corporation *M* to have use of the equipment for 13 years, including all renewal periods. Thus corporation *M* has gained possession and will have use of the equipment for substantially its entire useful life, even though it may never acquire legal title to such property.

During the first three years of use, corporation *M* is required to pay 116*x* dollars, whereas during the remaining 10 years of use corporation *M* is required to pay only 1*x* dollars per year or 10*x* dollars. In order to have use and possession of the equipment for 13 years, it is required to pay, disregarding taxes, insurance, etc., a total of 126*x* dollars, over 90 percent of which is to be paid in less than a quarter of the time for which it is permitted use and possession of the equipment.

In the light of these facts, it is held that the agreement executed by corporation *M* and corporation *N* will transfer equitable ownership to corporation *M* as it will enjoy all of the benefits of ownership for substantially the entire useful life of the property.

It is held, further, that corporation *N* has realized proceeds from sale of the equipment measured by the sum of the payments properly allocable to the sales price. Corporation *M* must capitalize the amounts properly allocable to the purchase price of the equipment and recover such capitalized cost by appropriate depreciation deductions over the estimated useful life of the equipment.

See Rev. Rul. 55-540, page 39, this Bulletin.