[COMMITTEE PRINT]

TAX SHELTERS: EQUIPMENT LEASING

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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GENERAL

A business may acquire productive equipment in a variety of ways, including an outright purchase or a lease of the equipment. The alternative of using leasing as a means of acquiring productive equipment has grown substantially in the past fifteen years. Some of the more common types of property and equipment which are presently leased include aircraft, computers, railroad rolling stock, ships and vessels, cable television systems, and oil drilling rigs. Also, utility companies have begun to lease nuclear fuel assemblies.

There are two basic types of equipment leases. The first is the so-called "net" lease. Under the net lease, the equipment is leased for a rental term approximating the useful life of the property, with the lessee assuming financial responsibilities which are normally those of the lessor (such as paying property taxes and insuring the property). Rent payments under a net lease also are ordinarily at a level which enables the lessor to service debt incurred to purchase the property, pay any other expenses, and provide a minimal positive cash flow. As a result, the lessor has very little risk under the net lease.

The other basic type of lease is the "operating" lease, under which the lessor assumes a significantly greater degree of risk than under the net lease. The operating lease is generally for a term less than the useful life of the property, and the lessor is responsible for paying such expenses as insurance and property taxes. Since this type of lease is for a relatively short term, and the original rentals by themselves will not pay off the debt incurred to purchase the property, the lessor in an operating lease takes the risk that rentals from subsequent leases of the property will be insufficient to service the financing costs and cover other cash flow expenses. There are significant differences between the tax treatment accorded net leases and operating leases. For example, individuals who lease equipment under an operating lease may be allowed the investment credit, while the credit would not be available under a net lease.

The equipment leasing shelter is a "deferral" type of shelter. Tax shelter benefits arise largely from postponing income taxes on income from other sources through losses generated by accelerated deductions during the early years of the equipment lease. The principal accelerated deductions are for depreciation under one of the accelerated methods, rapid (60-month) amortization, and prepaid interest. In addition, the use of leverage, through nonrecourse loans, is an integral part of the equipment leasing shelter. The lessor also may be eligible to claim the investment credit; however, the availability of the investment credit was substantially curtailed by the Revenue Act of 1971.

DESCRIPTION OF THE SHELTER

As is the case in many other types of tax shelters, the limited partnership is commonly used in the equipment lease transaction where sheltering of investors' income from other sources is a primary goal. In the typical equipment leasing shelter, a limited partnership is formed with the equity capital provided by a number of individual investors who become limited partners. The general partner is the promoter, and is often a corporation. Virtually all of the equity capital is provided by the investors (generally in amounts of not less than $5,000 each), with the general partner contributing little or no equity.

Prior to soliciting limited partnership interests, the promoter has often located a company which is interested in leasing computers, railroad rolling stock or some other type of business machinery or equipment, and has contacted a bank, insurance company or other lender to arrange for financing the equipment purchase. After the limited partnership interests have been sold and the equity capital received, a large portion of the equity capital usually is used to make a 20–25 percent down payment to purchase the equipment. The remaining part of the purchase price generally is financed on a nonrecourse basis, so that the lender's security for his loan is limited to a security interest in the equipment with neither the partnership nor any of the partners having any personal liability for the debt. (As a practical matter, the lender's primary security is the credit rating of the lessee and the lessee's ability to make the rental payments over the period.

The partnership generally leases the equipment to the lessee at a rental rate which, over the initial term of the lease, will enable the partnership to repay the loan, plus interest, fees and other expenses, and generate a modest positive cash flow.

In most leasing shelters, the limited partnership elects the method of depreciation or amortization which will generate the largest capital recovery deductions allowable in the early years of the lease. The partnership may, in addition, prepay some of its interest charges, and often, during the first year of operation, pays the promoter for management and syndication fees. The large depreciation, fees, interest, and other expenses generally exceed the partnership's receipts from rental of the equipment during the first 3–7 years of the lease (depending upon the estimated useful life of the leased equipment), and this generates sizable losses for the partnership.

Partnership losses are allocated to the investor-limited partners under the partnership agreement and are used by the individual investors to offset income from other sources (and thus defer taxes on this income for a number of years). The individual investor may also obtain an apportioned share of the investment credit if the equipment is eligible for the credit and the lease is of a type which enables an individual investor to claim the credit.

PRESENT LAW

Depreciation

A. Accelerated depreciation

The owner of tangible personal property used for the production of income is entitled to a deduction for depreciation. (Where a partnership owns the property, the depreciation deduction is passed through to the individual partners, generally in accordance with the partnership agreement.)

All tangible personal property may be depreciated on a straight-line basis, which provides that an equal portion of the property's basis (less salvage value) is deducted each year of the property's life. Tangible personal property used for the production of income (such as airplanes, computers and cargo containers) is eligible for "accelerated" methods of tax depreciation which allow large deductions initially, with gradually reduced deductions for each successive year of the asset's useful life. The accelerated depreciation methods allowed for equipment include the double-declining balance method [1] and the sum-of-the-years-digits method.[2]

A comparison of these accelerated depreciation methods with straight-line depreciation is illustrated by the following example involving an asset which cost $1 million and has a 10-year useful life. It is also assumed that salvage value is less than ten percent and therefore can be ignored. (sec. 167(f).)

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[1] The double declining balance method of depreciation, also known as the 200 percent declining balance method, allows a depreciation rate equal to twice the straight-line rate. The declining balance rate is applied to the unrecovered cost, i.e., cost less accumulated depreciation for prior taxable years. Since the depreciation base is reduced to reflect prior depreciation, the amount claimed as depreciation is greater in earlier years and declines in each succeeding year of an asset's useful life.

[2] The sum-of-the-years-digits method of depreciation is computed using a fraction, the numerator of which is the years' digits in inverse order and the denominator of which is the sum of the number of years. For example, if an asset has an estimated useful life of 10 years, the denominator is the sum of one plus 2 plus 3, etc., plus 10, or 55. The numerator would be 10 in the first year, 9 in the second year, etc. Thus, in the first year, the fraction would be 10/55, in the second year 9/55, etc. As in the case of the declining balance method, the annual depreciation is greater in earlier years and declines in each succeeding year of an asset's useful life.

Depreciation deductions allowed

Depreciation method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Straight-line	$100, 000	$100, 000	$100, 000	$100, 000	$100, 000	$100, 000	$100, 000	$100, 000	$100, 000	$100, 000	$1, 000, 000
Accelerated:											
Double declining balance	200, 000	160, 000	128, 000	102, 400	81, 920	65, 536	65, 536 [1]	65, 536	65, 536	65, 536	1, 000, 000
Sum-of-the-years-digits	181, 818	163, 636	145, 455	127, 273	109, 091	90, 909	72, 727	54, 545	36, 364	18, 182	1, 000, 000

[1] At this stage the taxpayer elects to claim straight-line depreciation for the remaining useful life of the property.

Under either of the accelerated methods shown above, the total depreciation deductions in the earlier years of an asset's life substantially exceed the total depreciation allowed under the straight-line method. This is not the case, however, in later years. In the above example, the depreciation to be claimed under the double declining balance method is less than under the straight-line method after the fourth year. Straight line depreciation exceeds sum-of-the-years-digits depreciation after the fifth year.

B. Additional first-year depreciation

An owner of equipment is also eligible to elect, for the first year the property is depreciated, a deduction for additional first-year depreciation of 20 percent of the cost of property (Sec. 179). The amount on which this "bonus" depreciation is calculated is limited to $10,000 ($20,000 for an individual who files a joint return). Bonus depreciation is also available only for property that has a useful life of six years or more. The maximum bonus depreciation is then limited to $2,000 ($4,000 for an individual filing a joint return).

Where the lessor is a partnership, the election for bonus depreciation is made by the partnership. However, the dollar limitation described above is applied to the individual partners rather than the partnership entity. For example, each one of 40 individual investors who contributed $5,000 to an equipment leasing limited partnership, which purchased a $1 million executive aircraft on a leveraged basis, would be entitled to $4,000 of bonus depreciation if he filed a joint return. In this case, additional first-year depreciation would provide a total deduction to the partners of $160,000.

The additional first-year depreciation reduces the depreciable basis of the equipment. However, the partnership is still entitled to claim, and the partners to deduct, accelerated depreciation on the reduced basis in the property both for the first year and for the later years of the property's useful life.

C. Asset Depreciation Range (ADR)

The ADR system for depreciation was authorized by the Congress in the Revenue Act of 1971 in order to bolster a lagging economy and to eliminate a number of difficult interpretative problems pertaining to depreciation which had arisen under prior law. The ADR system operates under regulations issued by the Treasury Department, and became effective in 1971. (Reg. § 1.167(a)–11.)

Under ADR, depreciation for tangible personal property (including leased property) may be calculated using a shorter than otherwise allowed useful life. The depreciation lives allowed under ADR may be 20 percent shorter than the lives established previously by the Internal Revenue Service as reasonable useful lives for depreciation of productive assets. (Rev. Proc. 62–21, 1962–2 C.B. 418.) This means, for example, that an asset with a depreciable useful life of 10 years under the previous guidelines may instead be depreciated over a period of 8 years under ADR, giving the taxpayer a type of "accelerated" depreciation deduction (even with straight-line depreciation).[3]

[3] In computing depreciation under the ADR system, a taxpayer also is entitled to use one of two first-year "conventions," or methods, on all assets first placed in service during any one tax year or period. Under the first of these conventions, the taxpayer may elect to claim a half-year's depreciation on all assets put into service at any time during the year. The other convention allows a full year's depreciation for all assets placed in service during the first half of the tax year and no depreciation (for the first year) on assets placed in service during the last half of the tax year.

D. Rapid amortization

Certain categories of assets which are subject to equipment leasing transactions are eligible for rapid amortization. Under the rapid amortization provisions, the costs for qualifying categories of property may be amortized over a period of 60 months in lieu of depreciation deductions otherwise allowable for these assets. Rapid amortization is allowed for pollution control facilities (sec. 169), railroad rolling stock (sec. 184), and coal mine safety equipment (sec. 187). These provisions are scheduled to terminate at the end of 1975.

E. Depreciation recapture

The equipment leasing shelter does not give rise to the "conversion" characteristic of many other types of shelters because of the full recapture rules that apply to tangible personal property. (Sec. 1245.) When tangible personal property is disposed of at a gain, the gain is "recaptured" as ordinary income to the extent of all previous depreciation deductions claimed on the property (not just accelerated deductions). The recapture treatment for tangible personal property differs from that accorded depreciable real property, which is generally limited to a recapture of the amount by which accelerated deprication deductions claimed exceeded those allowable on a straight-line basis.

In the case of a partnership, the individual partners are generally allocated a share of the partnership's depreciation recapture in accordance with the provisions of the partnership agreement concerning the allocation of partnership gains. The recognition of depreciation recapture by a partner may be triggered directly by a sale of the depreciated partnership property or indirectly by a disposition of the partner's interest in the partnership itself. Also, if a lender forecloses on the debt used to finance the partnership's purchase of the equipment, this is treated as a disposition which will trigger recapture. The amount "received" in a foreclosure will include the unpaid nonrecourse debt. If this amount exceeds the undepreciated basis in the equipment, there will be so-called "phantom gain" which is taxed as ordinary income to the partners.

Investment credit

As items of tangible personal property used in a productive capacity, the properties used in equipment leasing transactions are generally eligible for the investment credit, which, under the Tax Reduction Act of 1975, was increased to 10 percent through 1976.

An individual lessor (or individual investing in a limited partnership leasing transaction) may claim the investment credit only in two limited alternative situations.[3] (Sec. 46(d)(3).). In the first situation, a noncorporate lessor is allowed the investment credit if the property subject to the lease was produced or manufactured by the lessor. In the second situation, a noncorporate lessor will be allowed the investment credit where the term of the lease (including any renewal options) is less than 50 percent of the depreciable life of the property, and, for the first 12-month period after the property is rented to the

[3] The maximum credit which may be claimed for any one year by a married taxpayer filing a joint return is limited to $25,000 plus 50 percent of the tax liability over $25,000. This limitation is applied separately to each partner in a partnership.

lessee, the sum of the lessor's ordinary and necessary business deductions (under section 162) exceeds 15 percent of the lessor's rental income from the property. This is intended to allow the investment credit to an individual (or a limited partner) only where the investors are willing to accept the risks of a short-term "operating" type of equipment lease. Thus, the investment credit is not available in the typical net lease situation.

Leverage

As described in previous pamphlets dealing with tax shelters, the amount of loss a partner may deduct is limited to the amount of his adjusted basis in his interest in the partnership. (The partner's adjusted basis is reduced by the amount of any deductible partnership losses.)

Generally, the partner's basis in his partnership interest is the amount of his cash and other contributions to the partnership. If a partner assumes liability for part of the partnership debt, this also increases his basis. However, under the regulations, where the partnership incurs a debt and none of the partners have personal liability (a "nonrecourse" loan), then all of the partners are treated as though they shared the liability in proportion to their profits interest in the partnership and their bases are increased accordingly. (Regs. § 1.752-1(e).) For example, if a partner invested $10,000 in a partnership, in return for a 10-percent profits interest, and the partnership borrowed $100,000 in the form of a nonrecourse loan, the partner's basis in the partnership would be $20,000 ($10,000 of contributions to the partnership, plus 10 percent of the $100,000 nonrecourse loan).

Provisions of Tax Reform Act of 1969 and Revenue Act of 1971 Which Relate to Equipment Leasing

A. Limitation on deduction of excess investment interest

Under the 1969 Tax Reform Act, excess investment interest of individuals is subjected to a limitation with respect to the amount which is currently deductible. (Sec. 163(d).) This limitation on the deduction of excess investment interest, in general, provides that (for taxable years beginning after 1971) only one-half of the amount of excess investment interest in excess of $25,000 may be deducted currently. Interest expense disallowed under the limitation may be carried over and deducted in subsequent taxable years.

"Excess investment interest" is basically the amount of interest paid by the taxpayer with respect to property held for investment reduced by the net amount of investment income derived by the taxpayer from property of this type.

A "net lease" of equipment is considered an investment property, and a partner is required to take into account his distributive share of the partnership's investment interest and other items of income and expense for purposes of this provision.

B. Minimum tax on tax preferences

The Tax Reform Act of 1969 also provided for a 10 percent minimum tax on certain items of tax preference to the extent that they generally exceed $30,000 plus the regular income tax net of certain tax credits. Items of tax preference include, in the case of an individual investor in an equipment leasing partnership: excess investment interest (for taxable years before 1972), the excess of accelerated depreciation allowed over straight-line depreciation in the case of equipment subject to a net lease, and rapid amortization claimed on pollution control facilities and railroad rolling stock to the extent it exceeds depreciation otherwise allowable.

IRS RULINGS POLICY

Qualification as a Partnership

Generally, if the principal purpose of a transaction is tax avoidance, the transaction may be set aside for Federal tax purposes, with the result that the taxpayer will not receive the deductions resulting from the transaction to which he would otherwise be entitled. See *Court Holding Co.* v. *Commissioner*, 324 U.S 331 (1945). As a result, the Service generally will not issue a ruling letter with respect to any transaction where there is a serious question as to whether or not the principal purpose of the transaction is tax avoidance.

Recently, the IRS set forth guidelines which it will apply in determining whether the formation of a limited partnership is for the principal purpose of reducing Federal taxes. (Rev. Proc. 74–17, 1974–1 C.B. 438.) If these guidelines are not satisfied a favorable ruling letter will not be issued. However, the taxpayer is still free to argue (with an Internal Revenue agent, or before a court) that he is entitled to the deductions claimed in connection with the partnership.

The IRS guidelines are as follows:

(1) All of the general partners, in the aggregate, must have at least a one percent interest in each material item of partnership income, gain, loss, deduction or credit.

(2) The aggregate deduction of the limited partners during the first two years of the partnership's operations cannot exceed the amount of the equity investment in the partnership.

(3) No creditor who makes a nonrecourse loan to the partnership may acquire, as a result of making the loan, any direct or indirect interest in the profits, capital, or property of the limited partnership, other than as a secured creditor.

Previously, the Service had announced guidelines for the issuance of advance rulings where a corporation is the sole general partner in a limited partnership. (Rev. Proc. 72–13, 1972–2 C.B. 735.) Under these guidelines, the limited partners may not own more than a total of a 20-percent stock interest in the corporate general partner, minimum net worth is required of the corporate general partner so it will not merely be a "straw" entity, there must be no requirement that any limited partner acquire any security of the general partner or its affiliates, and the limited partnership must be organized under the applicable State partnership statutes.

Treatment of the Lease as a Conditional Sale

In equipment leasing transactions the partnership's claim that the transaction is a lease may be challenged by the Internal Revenue Service and treated as a sale of the equipment by the partnership instead of a lease. The treatment of such leases as sales will result in a total elimination of sheltering characteristics, including disallowances of the lessor's depreciation.

The Service has long been aware of the problem of determining whether a transaction is a lease or is in reality a sale with long-term financing. For a number of years, the Service has had a series of guidelines to determine the income tax treatment of purported leases of equipment. (See Rev. Rul. 55–540, 1955–2 C.B. 39.) Earlier this year the IRS set out criteria under which it will rule on whether a transaction is a lease. Under these criteria the Service will not rule that a leveraged lease of equipment constitutes a lease unless:

(1) The lessor's equipment purchase is leveraged to an extent less than 80 percent of cost.

(2) At the end of the lease term (including all renewal periods except option periods at a fair market rental rate), the leased property has a residual value of at least 20 percent of its original cost, and a remaining useful life of at least one year or 20 percent of the property's original useful life, whichever is longer.

(3) Any option to purchase by the lessee is based on the fair market value of the property at the end of the lease term.

(4) Neither the lessee nor any person related to the lessee (under section 318(a)) furnishes part of the lessor's cost of the property or guarantees any of the lessor's indebtedness for this purpose.

(5) The lessor demonstrates that it expects to receive an economic profit from the lease, apart from that generated by tax benefits.

(6) The level of rental payments also satisfies certain criteria.

If the lease does not meet these tests, it means that the Service will not give an advance ruling on the lease transaction. Of course, the taxpayer is free to test the validity of the transaction in court if challenged on audit by the Service.

Prepaid Interest

In 1968, the Service issued Rev. Rul. 68–643, 1968–2 C.B. 76, which, using distortion of income as its main criterion, in effect, restricted prepayment of interest to the taxable year succeeding the year of prepayment. Moreover, the Service cautioned that even with respect to those prepayments for the year succeeding the year of prepayment (i.e., for a period not more than 12 months beyond payment), material distortions of income could result in a disallowance of all or part of such prepayment. Recently, the position taken by the Service has been sustained, for the most part, in two cases, *Sandor*, 62 T.C. 469 (1974), (prepayment of five years' interest), and *Burck*, 63 T.C. 556, (1975), (prepayment of one year's interest).

Expenses of Syndication

Until recently, in the case of an equipment leasing partnership, as in the case of tax shelters generally, it has been the common practice for limited partners to deduct the payments made to the general partner for services in connection with the syndication and organization of the limited partnership. However, recently the IRS ruled that such payments to general partners constitute capital expenditures which are not currently deductible. (Rev. Rul. 75–214, 1975–23 I.R.B. 9.) Nevertheless, because of the past practices of taxpayers deducting these payments, it might be appropriate to further clarify the law in this area.

PROBLEM

Equipment leasing attracts investors in high tax brackets for whom the tax deductions and credits (described earlier in this pamphlet) are more valuable in terms of his income after taxes than would be the earnings on a direct equity investment. For the lessor, the accelerated depreciation and relatively short useful lives of the assets represent significant tax deferral. Moreover, these deferral benefits are magnified appreciably by the use of leverage. Because of the recapture rules presently applicable in the case of equipment leasing, there is no conversion of ordinary income into capital gains.

The reasons why the business firms which lease the equipment will use this form of financing, rather than more traditional methods, vary considerably among industries. One significant factor that frequently influences the decision is the inability of the company to take full advantage of the investment credit and/or rapid depreciation deductions because of low profits or losses. From the standpoint of the companies involved, equipment leasing may be desirable because the firms might otherwise be unable to finance the acquisition of new equipment. However, equipment leasing may deter structural adjustments in the lessee firms and industries necessary to restore the rate of return or investment to a competitive level. In addition, the use of special tax deductions in these cases tends to divert investments to firms where investments may not be economic and in this way distort the allocation of investment funds among all industries. This means that investable funds do not go to the most productive investment opportunities.

In addition, business firms which finance the acquisition of equipment in this fashion increase their contractual payments, which has much the same effect on them as an increase in their debt.

The equipment leasing industry is highly leveraged and is vulnerable to interruptions in the flow of payments. If the lessee is encountering unexpected losses and defaults on his payments, the sequence of defaults through the linkage of financial arrangements limits loanable reserves of lending institutions more than would be the case with more traditional routes for financing equipment acquisitions.

It has been argued that it is not equitable to allow the large deferrals of income tax by individual investors in a leasing transaction. The basis for these arguments is that the utilization in this way of the tax incentives provided to encourage the acquisition of productive equipment constitutes a misuse of these incentives. This is the case since the losses which create the deferrals are generated by accelerated depreciation or amortization methods which allow large early deductions in excess of the actual reduction in the value of the equipment. In addition, the use of nonrecourse financing enables an investor in an equipmet leasing limited partnership to deduct losses which far exceed the actual amount of equity capital he has placed at risk by investing in the partnership.

Because of the present tax situation, when an investment is solicited in an equipment leasing venture, it has become common practice to promise a prospective investor substantial tax losses which can be used to decrease the tax on his income from other sources.

ALTERNATIVE APPROACHES

There are a number of alternative approaches the committee could consider to deal directly or indirectly with equipment leasing shelter investments. If the committee believes that certain incentives are no longer desirable or that the tax benefits from these incentives are greater than they need be, the committee could revise the provisions directly, and eliminate or cut back the tax incentives to some extent. For example, the committee could consider limiting the use of accelerated and bonus depreciation and requiring the capitalization of syndication fees and prepaid expenses. In addition, the committee could consider certain changes to the partnership tax provisions (such as not allowing deductions in excess of a partner's equity in the partnership or not allowing nonrecourse loans to increase a partner's basis).

On the other hand, if the committee believes that certain incentives should be continued for equipment leasing but that the tax benefit involved should not be available to offset income unrelated to that activity, then the committee could consider limiting the tax write-offs to income from that particular activity. This would prevent the use of excess deductions to shelter other income.

This is the approach that the Administration adopted in its limitation on artificial loss (LAL) proposal made in the tax reform presentation to the committee on April 30, 1973, and essentially adopted by the committee (with certain modifications) in its 1974 tax reform bill, as described below.

A third approach to deal with equipment leasing tax shelter investments could be considered if the committee decides against either of the first two approaches. If the committee believes that there is a desired objective for continuing the tax incentives and that revising the provision directly or applying an LAL approach would unduly restrict their purpose, then the committee could consider dealing indirectly with the preferences, such as by broadening the application of the minimum tax.

The following is a summary of the committee's decisions with respect to equipment leasing in its 1974 tax reform bill and, in addition Mr. Ullman's alternative proposal.

Limitation on Artificial Losses

A. 1974 Committee Bill

To prevent taxpayers from sheltering unrelated income from taxation by deducting the accounting losses attributable to accelerated deductions for equipment leasing activities, the 1974 committee bill provided for the deferral of the deductibility of accelerated deductions attributable to personal property subject to a net lease to the extent the deductions for a taxable year exceed the taxpayer's net related income from the property. The net related income would be equal to the gross income from a leased property, less the "ordinary deductions" attributable to the property (deductions other than the accelerated deductions for that year). The accelerated deductions in excess of net related income would be suspended for use in a later year. The limitation would apply on a property-by-property basis.

The limitation would not apply to losses which represent true economic losses not attributable to accelerated deductions; thus these losses would continue to be deducted currently.

For purposes of applying the limitation on artificial losses in the case of equipment leasing, the accelerated deductions to be taken into account would consist of the deductions for accelerated depreciation and rapid amortization. The depreciation to be treated as an accelerated deduction is that portion of the depreciation or rapid amortization taken in excess of the amount that would be allowed under the straight-line method for computing depreciation.

The limitation would apply to individuals (and estates and trusts) and to electing small business corporations (subchapter S corporations).

Deferred deductions.—The amount of the accelerated deductions attributable to an equipment leasing activity which is deferred would be reflected in a deferred deduction account. The deferred deductions would be allowed in subsequent taxable years against the taxpayer's net related income from that equipment leasing transaction. The amount allowable with respect to the deferred deductions for a subsequent taxable year would be limited to the amount by which net related income from each leased property exceeded the accelerated deductions from the property for that taxable year. The amount allowable could not, of course, exceed the balance of the deferred deduction account. Special rules would be provided to permit the allowance of deferred deductions when there is a disposition of the property giving rise to the deductions.

Under the 1974 committee decision, a separate deferred deduction account would be maintained for each class of property subject to the provisions, i.e., a net lease class, a farm class, etc. The net lease class would include personal property subject to net lease and of the type subject to the depreciation recapture rule of present law. A property is subject to a net lease if the lessor's ordinary and necessary business deductions for a taxable year are less than 15 percent of the rents from the property, or the lessor is guaranteed a specified return or is guaranteed against loss of income.

B. Mr. Ullman

His proposal is the same as that in the 1974 committee bill, except that he would apply LAL to all leases rather than only net leases.

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