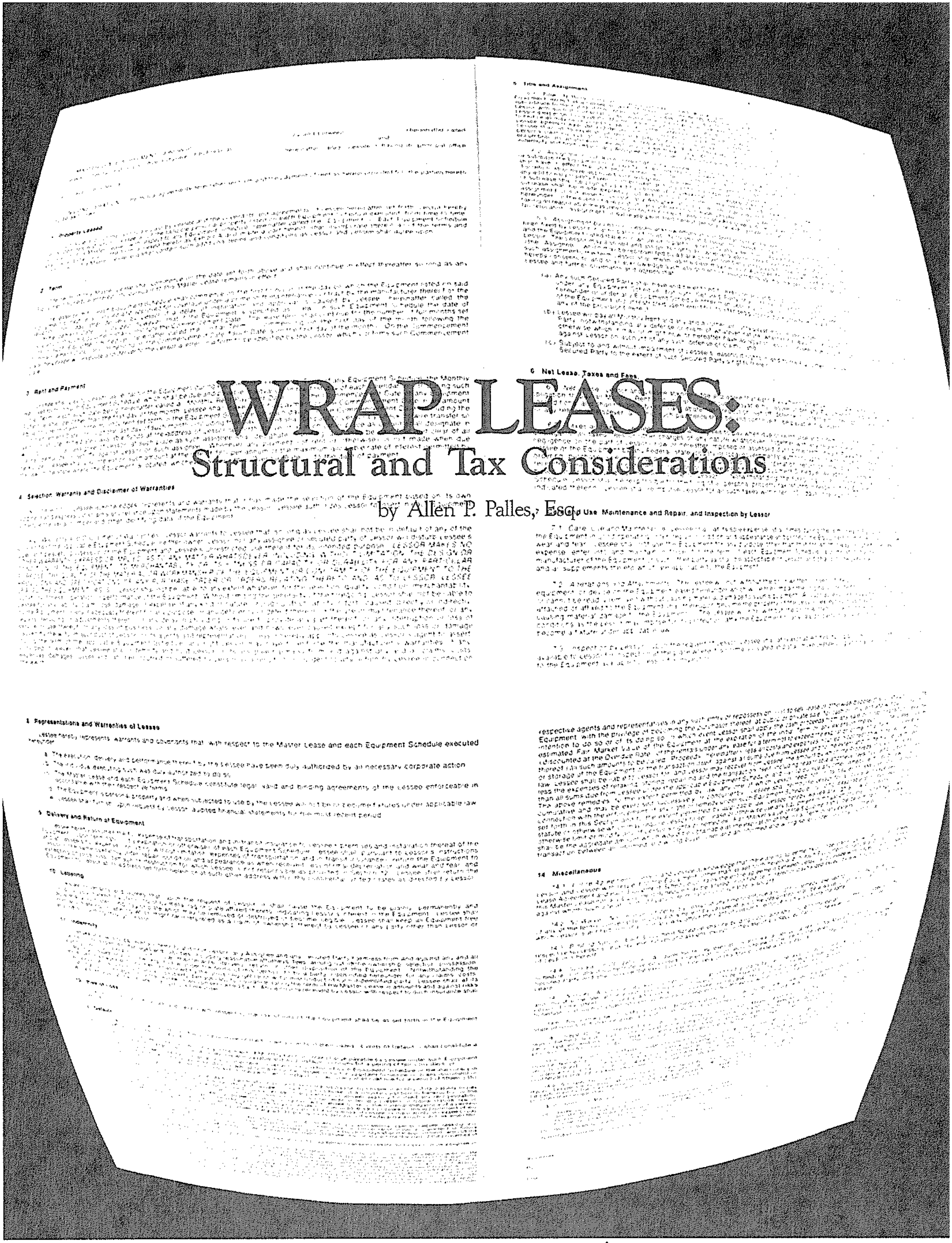
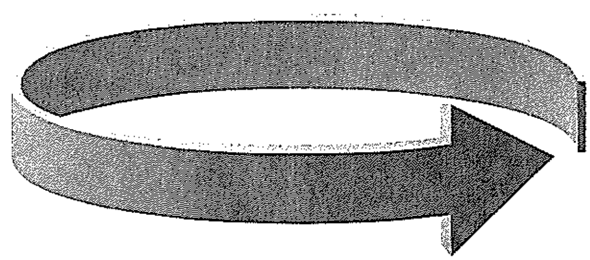



# WRAP LEASES:
## Structural and Tax Considerations

by Allen P. Palles, Esq.



One of the more controversial structures used by the equipment leasing industry is the sale/leaseback wrap-around transaction (the "wrap"). It has been characterized by some as primarily tax-motivated. While virtually all leasing is associated with tax attributes, when the wrap is properly structured and analyzed it becomes clear that it is merely a structural variation of the leveraged lease. This article, while not an exhaustive exploration of the subject, is intended to discuss the fundamental economic, structural and tax aspects of the wrap.

## ECONOMICS

The equipment leasing industry historically has provided capital to users of equipment in the form of sale/leasebacks. While this mechanism has been more predominant in the real estate industry, equipment lessors have engaged in sale/leaseback arrangements so as to provide an additional source of capital to their clients which, secondarily, result in transference of tax attributes. The wrap is fundamentally a sale/leaseback and is a mechanism for providing an alternate capital source *to equipment lessors.* It is used in the same way and for the same purpose that lessors use sale/leasebacks for their customers and clients.

The wrap has come into more frequent use as the equipment leasing industry's need for capital has increased and its ability to take on additional risk and to make effective current use of tax attributes has decreased. The relative balances of the sharing of economic benefits and burdens in the wrap has shifted as these economic requirements have shifted.

While computers—mainframes and peripherals—have been the primary type of equipment used in wraps, in the late 1970s lessors began using the wrap in conjunction with operating leases of transportation equipment (railcars, aircraft, semitrailers). Its use has now been expanded to virtually all equipment types.

The most obvious effect of use of the wrap on the equipment leasing industry has been increased cash flow, more effective pricing for lessees, and transference of risk. These results have a beneficial impact on capital formation in general, and the leasing industry in particular. Why, then, does so much controversy surround the wrap?

Essentially, the viability and credibility of lessors is in many ways associated with the "economic substance" of the structure of the business in which they engage. This writer, for one, believes that "economic substance" should not be *totally* dependent on the tax attributes of an equipment lease nor should it be *totally* separated from tax attributes. It is in this regard that most critics of the wrap have expressed concern. They argue, with some possible degree of validity, that the structure may have, at times, been *misused* as a mechanism for transferring tax attributes in situations that have no other economic motives or substance, thus resulting in an adverse impact on equipment lessors.[1]

Critics further argue that investors in wraps (who have been primarily individuals and corporations who do not normally engage in leasing) are not sufficiently sophisticated to be able to properly evaluate the "economic substance" of an equipment lease transaction.[2]

Recent experience dictates to the contrary. Investors in wrap transactions have become a significant source of capital to the leasing industry. Wraps are believed to have accounted for at least $2 billion of volume in 1983. When coupled with other types of "syndicated" equipment lease transactions, one must conclude that nontraditional lessors have become a significant source of capital to the leasing industry.

As use of the wrap expanded, diligence on the part of investors has expanded dramatically. Virtually all investors are now requiring extensive support of the economic viability of the transaction. Further, involvement of major investment banking firms has led to intensified diligence.[3]

In short, the wrap is nothing more than a device for providing capital to the leasing industry in a form that it has been continuously using when it provides capital to its customers. If a lessor transfers a meaningful portion of

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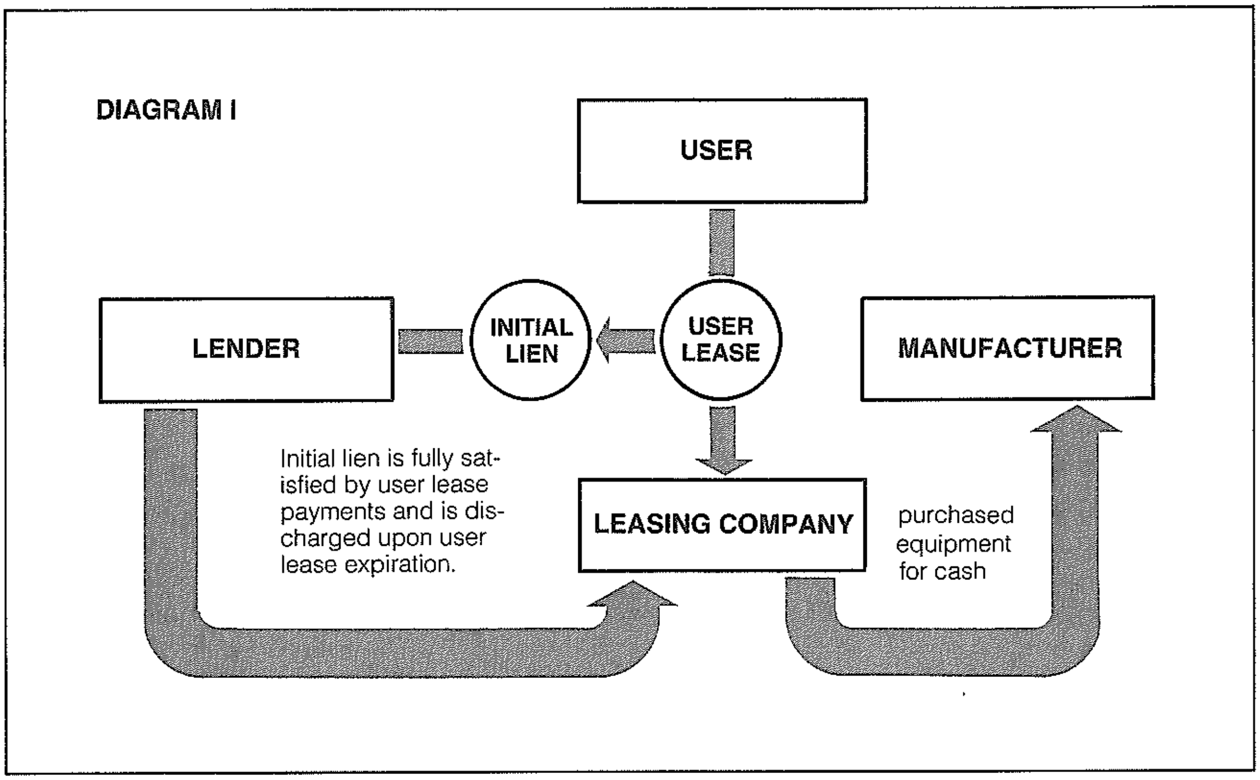
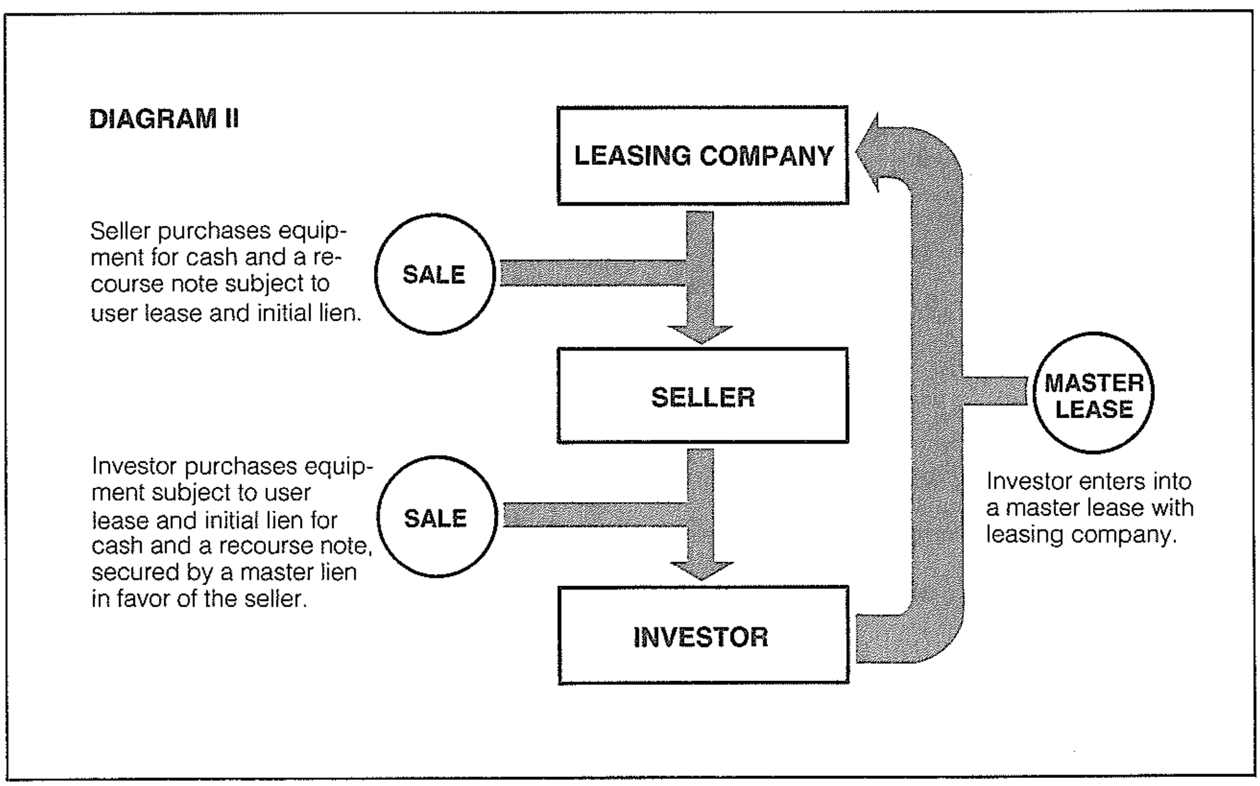
TABLE 1

# WRAP LEASE

*These diagrams illustrate the events described in the typical transaction.*



the economic benefits of a transaction (exclusive of tax attributes) to an investor in a wrap, the "economic substance" maxim should be established. Whether or not benefits (and burdens) have been transferred can only be analyzed on a case by case basis. A clear understanding of the wrap structure is essential to such an analysis.

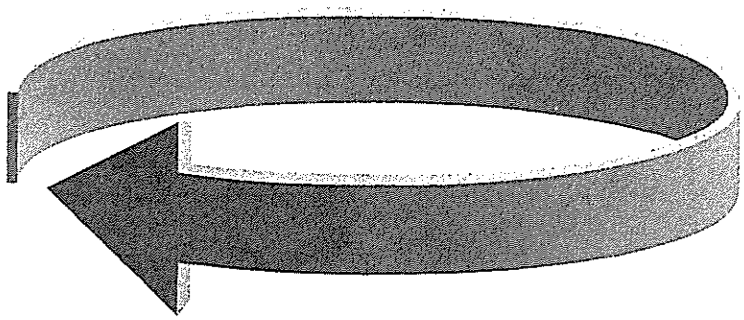


Table 2

**ANALYSIS OF CASH FLOW**

**CASH TO ABC LEASING COMPANY WITHOUT A WRAP LEASE**

| | |
|---|---|
| Equipment cost | $(1,000,000) |
| Bank financing | 900,000 |
| Net investment | (100,000) |
| Rent received from user in excess of debt service to bank—months 1-60 ($200/mo.)* | 12,000 |
| Rent months 61 thru 84 | 120,000 |
| Residual | 150,000 |
| PROFIT TO LEASING COMPANY | $ 182,000 |

*60 months of rent at $20,000 per month, less 60 months of debt service at $19,800 per month.

## STRUCTURE

There are as many structural variations to the wrap as there are companies using it. The structure that is illustrated in Table 1 is typical. I am sure however that other structures are mere variations on a theme.

The first step in any wrap is the arrangement by the leasing company of an initial lease for the equipment involved (the initial user lease).[4]

This step can involve purchase of new equipment from a manufacturer, as is illustrated, or a sale/leaseback of used equipment with the initial lessee.

Following completion of the initial user lease, the leasing company will normally finance its acquisition of the equipment on a nonrecourse basis by assignment of the initial user lease to a financial institution (the underlying financing). In some cases underlying financing is not completed until after the equipment is sold to an investor, as discussed below. However, in syndications, the transaction is virtually impossible to complete in this way.

After arrangement of underlying financing, typically, the equipment is sold for its fair market value to a packager or financial intermediary. The packager may be an affiliate of the leasing company, but in most cases is unrelated.

The consideration paid by the packager normally takes the form of cash and an installment note or notes (the packager installment note). In some cases the cash portion may be staged in over a period of time.

The packager installment note always amortizes over a term exceeding the term of the initial user lease. Depending on the economic and tax requirements of the transaction, the packager installment note may be recourse, secured or unsecured. Some authorities believe that the packager installment note should not be secured by the equipment, and should be a recourse obligation of the packager in order to strictly comply with some interpretations of the "at risk" provisions of the Internal Revenue Code.

Following completion of sale of the equipment to the packager, it sells the equipment to a lessor/equity investor. This sale generally occurs immediately after the packager's acquisition of the equipment from the leasing company. The terms of sale to the investor are similar to the terms of sale by the leasing company to the packager—cash and an installment note (the investor installment note).

If the investor's equity is periodically staged, the deferred equity will be evidenced by a full recourse note and at times will be secured by a letter of credit and accompanied by an estoppel agreement (particularly where the transaction is part of a syndication). The investor's installment note is always secured by a lien on the equipment in favor of the packager. Depending on the circumstances, the investor installment note may or may not be recourse.[5]

The final step is the lease of the equipment by the investor to the leasing company (the wrap lease). The term of the wrap lease will exceed (or wrap around) the term of the initial user lease, but will be for a period that is less than the useful life of the equipment. The term of this lease will

Table 3

## ANALYSIS OF CASH FLOW

### CASH TO ABC LEASING COMPANY USING A WRAP LEASE

| | |
|---|---|
| Net investment (as in Table 2) | $(100,000) |
| Proceeds of sale to the lessor/equity investor | 150,000 |
| Net "profit" at closing | 50,000 |
| Rent received from user in excess of debt service, as in Table 2 | 12,000 |
| Rents for months 61 thru 84 | 120,000 |
| Excess of rent paid to lessor/equity investor over note payments from packager* | (33,600) |
| Additional rent paid to lessor/equity investor in months 61 thru 84** | (60,000) |
| PROFIT TO LEASING COMPANY | $ 88,400 |

*Rent of $14,900 per month for 84 months, less packager installment note payments of $14,500 per month for 84 months.

**50% of monthly rents from month 61 thru 84.

typically match the period over which the investor installment note amortizes. The fixed rents payable by the leasing company to the investor will be at least equal to the amortization of the investor installment note issued to the packager and the transaction will always be *at least* cash neutral during the term of the wrap lease. Depending on equipment residual expectations, the investor may insist that the fixed rent significantly exceed the note amortization. That is, the investor's economic profit potential will consist of cash flow during the lease term and residual ownership. The wrap lease normally requires that the leasing company pay contingent additional rent from all of, or a portion of, the net revenue derived by the leasing company after expiration of the initial user lease and before expiration of the wrap lease.

The structure can best be illustrated by the following simple example.

*On January 1, ABC Leasing Company enters into a 60-month lease with XYZ User for $1 million in equipment recently purchased by ABC from a manufacturer (the initial user lease). The rent paid to ABC is $20,000 per month.*

*ABC finances the initial user lease with GRDE Bank on a nonrecourse basis for 60 months at approximately 12% per annum. Payments to the bank are $19,800 per month. Bank advances $900,000 leaving ABC with a $100,000 investment.*

*ABC sells the equipment for its fair market value of $1 million to SKNE Packager. The purchase price is payable by SKNE with $150,000 in cash at closing and by delivery of a packager installment note in the amount of $850,000 payable in 84 monthly installments of principal and interest of $14,500 per month.*

*SKNE sells the equipment to an investor for $1 million, payable $150,000 at closing and by delivery of a secured investor installment note in the amount of $850,000 payable in 84 monthly installments of principal and interest of $14,550 per month.*

*The investor enters into a wrap lease of the equipment with ABC Leasing Company for 84 months at a fixed monthly rental of $14,900. In addition, the investor will receive 50% of all net proceeds received by ABC from the releasing of the equipment to XYZ User or to a new user between the 61st and 84th month of the wrap lease.*

*The investor has the option of causing ABC to remarket the equipment at the end of the 84-month lease term for which ABC will receive a market rate fee.*

*The equipment has an economic useful life of ten years and an expected residual of 15% of original cost at the end of 84 months. The rental value of the equipment in months 61 through 84 is $5,000 per month.*

Tables 2 through 4 illustrate the economic result (without consideration of tax attributes) to the leasing company and the investor. Assuming the facts occur as illustrated, ABC has transferred about half of its pretax cash profit opportunity of $182,000 to the investor and packager.

Table 5 illustrates the tax impact of the wrap on the leasing company and the investor. As can be seen, the wrap significantly affects the timing of taxable income and loss to the leasing company. This shift in timing is precisely equal to the timing of tax losses and income to the investor. A similar effect is obtained in every sale/leaseback transaction. Obviously, over the term of the transaction taxable income and loss of the parties is equal to "economic profit." Keep in mind that the analysis does not focus on internal rate of investment return, but on the flow of cash and tax attributes between the parties.

There are a few critical components in the structure of the wrap that require further exploration before turning to tax issues.

◆ **Fair Market Value** In many cases, the price paid for the equipment by the investor exceeds the price paid by the leasing company on its initial purchase of the equipment. This occurs primarily where the leasing company has made a bulk purchase of equipment at a discount or where a wholesale purchase of new or used equipment has been made. The leasing company may support the selling price to the investor with appraisals or comparisons to list price.

◆ Because of over-valuation issues many packagers are refusing to permit a markup of equipment cost unless value is well supported by independent parties.

◆ **Relationship with Packager** In some circumstances, the packager has been an affiliate of the leasing company. In these cases, it is obviously difficult to establish the arm's length nature of the relationships between the parties. Many authorities feel that relationships with an independent packager are essential for supporting the arm's length nature of the transaction. In addition, many packagers have now developed an independent distribution expertise that truly adds value to the transaction.

◆ **Flow of Cash between Parties** is approached in two ways. In the simplest method, the only cash that actually flows to the investor is the excess of fixed rent and renewals under the wrap lease over the investor's debt service to the packager. The balance of all remaining payments are covered by standing acknowledgement letters between the parties. This method has been used for years in sale/leasebacks, but may raise issues with respect to the substance of the transaction. The most protective *and* substantive method for handling flow of cash between the parties results from use of irrevocable letters between the parties directing their banks to make the appropriate transfers at the appropriate time.

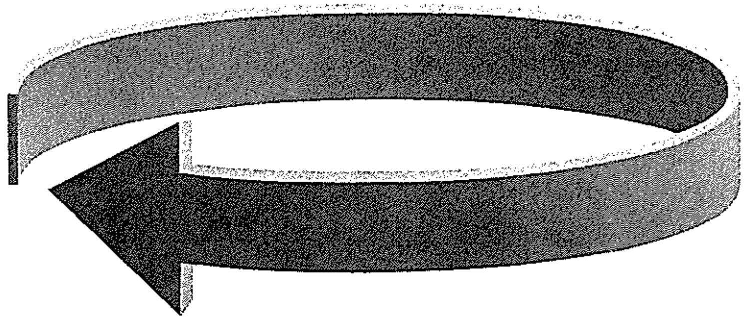


Table 4

**ANALYSIS OF CASH FLOW**
**CASH TO LESSOR/EQUITY INVESTOR**

| | |
|---|---|
| Initial cash investment | $(150,000) |
| Rent received from leasing company in excess of debt service to packager* | 29,400 |
| Additional rent received from the leasing company in months 61 thru 84 | 60,000 |
| Residual realized | 150,000 |
| PROFIT TO LESSOR/EQUITY INVESTOR | $ 89,400 |

*Rent of $14,900 per month for 84 months less debt service to packager of $14,550 per month for 84 months.

◆ **Soft Income** Like most sale/lease-backs, the wrap creates "soft" taxable income (that is, income without cash) in its early years and soft tax losses in later years. The soft income and losses are precisely equal to the tax attributes transferred to the investor. In the example, the leasing company will report $348,800 in taxable income in the first five years of the lease, using a wrap and $88,000 in tax losses if a wrap isn't used (a difference of $436,800 per $1 million in equipment). During the same period, the leasing company has generated only $150,000 in additional cash (the cash portion of the investor's purchase price). This obviously necessitates use of a wrap by a leasing company who has a surplus of tax losses or credits. This problem, if it is a problem, can be dissipated through the use of a number of techniques. In a technique similar to one used in leveraged buyouts, it is possible for the leasing company to joint venture with another entity capable of absorbing the soft income.

A number of structural variations have been developed that are of significance, the most important of which eliminates the use of a packager and the pledge of the initial user lease to a financial institution.

When a packager is eliminated, the equipment is sold directly to the investor by the leasing company. The investor then finances its purchase by assigning the *wrap lease* to a financial institution. This can be accomplished only when the credit of the leasing company is well-established.

In another variation, the leasing company finances its acquisition of the equipment from internally generated funds and does not obtain secured nonrecourse financing by assignment of the initial user lease. This is done where the leasing company is a major "single investor" lessor and has sufficient unsecured borrowing capacity.

Table 5

**TAXABLE INCOME OR LOSS TO THE PARTIES**

| Year | To ABC Leasing Company | | To the Lessor/ Equity Investor |
|---|---|---|---|
| | No Wrap | Wrap | |
| 1 | $ (200) | $ 53,100 | $(53,900) |
| 2 | (61,600) | 59,900 | (122,400) |
| 3 | (31,900) | 68,300 | (100,800) |
| 4 | (9,700) | 78,100 | (87,800) |
| 5 | 15,400 | 89,400 | (74,600) |
| 6 | 60,000 | (121,400) | 180,800 |
| 7 | 210,000 | (138,700) | 348,100 |
| | $182,000 | $ 88,400* | $ 89,400* |

*Difference between totals and total profit of $182,000 is the profit realized by the packager over the term of the transaction.

## TAX CONSIDERATIONS

The tax requirements of the wrap structure are, in general, identical to those of any leveraged lease transaction. The tax controversies relating to the wrap center in three primary areas:

- The wrap generally meets some but not all of the ruling requirements set forth in Rev. Proc. 75-21, etc.[6] Thus, a wrap is automatically thrust into the realm of the uncertainty of private letter rulings, legal opinions and apparently inconsistent case law. It is clear however, in the ultimate sense, that the IRS and the courts do not rely on the objective requirements of Rev. Proc. 75-21, etc., but more rationally rely on the subjective tests of economic profit motive and shifting of benefits and burdens of ownership.

- There is little dispute that the structure of the wrap optimizes tax attributes. Case law is clear that a taxpayer is entitled to structure its affairs in a manner that minimizes its tax burden, so long as minimization of tax burden is not the sole purpose for the investment or structure of the transaction. It is thus possible for the *form* of the wrap lease to be disregarded and treated as a sale if the investor is deemed to hold insufficient ownership attributes.[7]

- The IRS and, most likely, the courts will disregard a transaction (irrespective of its form) where there is no profit motivation (exclusive of tax attributes) and business purpose. A number of early wraps involved circumstances where (1) the term of the wrap lease may have been extensively long in relation to equipment life, (2) fair market value may have been inadequately supported, (3) the leasing company retained a substantial share of residual and residual expectations were unrealistic or unsupported, and (4) the leasing company retained full authority with respect to refinancing of equipment and the investor appeared to assume no responsibilities of ownership. In these cases, transference of tax attributes appeared to be the sole purpose for the transaction and the IRS disregarded them in their entirety.[8]

When all of the above factors are combined (noncompliance with objective ruling standards, high tax motivation, and inadequate demonstration of economic substance) *any* lease transaction can become suspect. As private letter rulings and case law evolved and analytical sophistication increased, it is clear that greater emphasis was placed on economic substance in wraps.

While no objective rules exist, I think, at least with respect to the more obvious tax issues discussed above, that the investor or its advisors should apply the following standards when considering an investment in a wrap transaction (or any lease investment):

- The investor should be able to demonstrate that a nondiscounted cash-on-cash return is expected, exclusive of tax attributes, from cash flow during the term of the wrap lease and residual. Multiple (and reputable) appraisals of renewal rent opportunities and residual values should be obtained.[9]

• Reputable evaluations of fair market value and equipment life in relation to the term of the wrap lease also should be obtained. Obviously, if the equipment is sold to the investor at a price in excess of fair market value and leased back for excessive periods, the viability of the transaction can be questioned.[10]

• Compare the present value of the rents from the initial user lease plus residual value at the end of the user lease to the investor's purchase price. If there is a substantial disparity between the two, require an explanation of how market value was determined. If the equipment is new, compare the investor's purchase price to available list prices.

• Since the wrap lease is a net lease, there are few ministerial burdens of ownership (insurance, maintenance, taxes) assumed by the investor. Thus, if the investor also gives the leasing company absolute discretion in refinancing and remarketing, indicia of ownership have been stripped to a minimum. The investor should, as a rule of thumb, retain some authority over remarketing and refinancing which are the primary remaining risks of ownership in a net lease.[11]

• If the leasing company has the right to remarket the equipment at termination of the wrap lease, the remarketing arrangements should be at arm's length (that is, the remarketing fee should be comparable to industry standards). Time periods and objective remarketing standards should be established. In a number of recent transactions, the investor has been permitted to use other companies to remarket the equipment.

• There is no objective method for determining *how much* cash-on-cash return must be present to insure viability. It is also clear that every lessor includes tax attributes in measuring *rate* of *return*. While the IRS uses discounting as a test to determine if further inquiry is required on audit, the courts have not evidenced an inclination toward adopting use of a discounting method for purposes of determining economic viability. Thus, the requirement for cash-on-cash return may not be substantial and may vary in accordance with each investor's criteria, but the expectation of cash-on-cash return must be realistic and demonstrable when considering all facts and circumstances.[12]

• Tax deferral mechanisms such as step-up rents, cash/accrual differences, balloon payments, and the like, should be used only when the commercial reasonableness of those techniques is established.[13]

• It is most important to insure that the leasing company, packager and promoter of the transaction are experienced and reputable. Large capitalization isn't essential. There are many small, very reputable and experienced companies who sponsor wrap transactions.

If each of the above standards are considered by the leasing company and the investor, the viability of the wrap transaction is likely to be favorably compared to any lease transaction.

There are other more esoteric tax elements in the wrap that do not necessarily affect the treatment of the transaction as a true lease, but would limit or change the timing of deductions by the investor.

The primary esoteric risk relates to the "at-risk" limitations of IRC Section 465. The tax losses of individuals and certain closely held corporations who are investors would be subject to limitations to the extent that they are not "at-risk" in a wrap.

• Under IRC Section 465 (b)(3)(B) an investor who is required to be "at-risk" could not include the investor installment note in its "at-risk" amount if the amount is considered to be "borrowed from any person who has a capital interest (other than an interest as a creditor)" in the activity.

• Under proposed Treasury regulations, the investor installment note is not included in "at-risk" amounts if the packager is considered to have either a capital or net profits interest in the activity.[14] The mere fact that the packager holds a lien on the equipment and would receive foreclosure proceeds would not give the packager a capital interest in the activity. If however, the packager retains a *net profit* interest in the residual, it may have a net profits interest in the activity.

• The fact that the leasing company holds a residual remarketing interest based on *gross income* should be insufficient in and of itself to support the position that the leasing company has a net profit interest in the activity.[15] However, if the packager is treated as a mere conduit, with the result that the investor pays debt service on the investor installment note to the leasing company (through the packager), the investor installment note may be treated as borrowing from an entity (the leasing company) who has a net profits interest in the lease.

In order to avoid these pitfalls, it may be best to insure that the leasing company and packager are unrelated; the leasing company does not hold a lien on the equipment from the packager; the leasing company's residual or remarketing interest is based on gross revenue; and that the packager is itself a substantive entity and that its relationship with the parties is "commercially reasonable."

Keep in mind that Section 465 gives Treasury reasonably broad authority and no final Treasury regulations exist for Section 465. These issues should always be reviewed by competent tax counsel.

Other more complex tax issues have to be considered. For example, does the fact that the leasing company has a residual interest mean that a partnership has been created between the leasing company and investor? This issue was explored inconclusively in a recent case.

## CONCLUSION

There is no question that the leasing industry, the IRS, courts and Congress are concerned justifiably about use of tax shelters whose *sole purpose* is avoidance of tax. Appropriate steps are being taken to discourage such transactions.

As this article points out, the wrap is merely a form of leveraged lease. As with all leveraged leases, the issue of economic substance is not necessarily susceptible to objective numerical tests. The definition of economic substance is much like that of obscenity: "I can't define it; but I know it when I see it."

Clearly, if the economic viability of a wrap is properly supported and the tax issues are properly considered, it is a useful and appropriate investment tool consistent with the spirit and letter of tax policy.

When a leasing company is using the wrap vehicle, it is, in fact, using the investor's asset and is in some way acting in a fiduciary capacity. We should treat the asset and the transaction in that light.

# FOOTNOTES

1. See, *Rice's Toyota World, Inc. v. Commissioner*, 81 T.C. No. 16 (August 29, 1983).

2. While a discussion of securities law aspects of wraps is not within the scope of this article, the Securities and Exchange Commission recently, in a refusal to issue a "no action" letter, concluded that a wrap was a security. *Meridian Leasing Corp.*, ("no action" letter available January 19, 1984).

3. Private transactions on a one-on-one basis have diminished while syndications have expanded dramatically.

4. The initial user lease is normally accounted for as an operating lease by the parties.

5. If the investor is required to be "at risk," the note will be at least partially recourse. In some situations the recourse obligation can be deferred in the event of a default.

6. Revenue Procedure 75-21, 1975 C.B. 715. However, the Revenue Procedure specifically states that its guidelines do not attempt to define, as a matter of substantive law, whether a transaction is a lease for tax purposes.

7. See National Office Technical Advice Memorandum, Ltr. 8418006, December 9, 1983. The IRS concluded, in a wrap structure similar to the example in this article that the lessor (investor) was not the owner of the equipment and that the wrap lease was not a true lease for tax purposes. Heavy emphasis was placed on the IRS view that there was an "inadequate" shifting of the benefits and burdens of ownership (see footnote 10).

8. Cf *Rice's Toyota World*, supra; *E.A. Brannen*, 78 T.C. 471 (1982). In *Rice*, the court held that a purchase and leaseback of computer equipment was a sham, on the ground that the taxpayer lacked a business purpose for entering into the transaction and there was no "realistic hope of profit." Based on the testimony of expert witnesses regarding residual values, the court concluded that the taxpayer would not even recover its initial investment. The taxpayer in *Rice* was to receive only 70% of any residual value and the purchase price in *Rice* exceeded the fair market value of the computer. The case emphasizes the importance of residual values and the necessity that investors conclude that there is a realistic hope of profit, apart from tax benefits. For an excellent discussion of the *Rice* case and the tax consequences of equipment sale/leasebacks, see Rubinstein and London, "Sales and Leasebacks: Some Valuation Problems," *The Tax Lawyer*, Vol. 37, No. 3, Spring, 1984.

9. In *Rice*, the Tax Court seemed to acknowledge that tax deferrals were the primary factors considered by the investor, but permitted appraisals that were attained only in conjunction with the litigation (and not at the time the transaction was closed) in support of the taxpayer's profit motive. Clearly, contemporaneous appraisals may have been more persuasive.

10. If the investor's purchase price exceeds fair market value by 200%, "gross overvaluation" penalties may be assessed under the Tax Equity and Fiscal Responsibility Act of 1982. In overvaluation situations, two arguments are made: (a) The investor's basis is overstated, particularly if the investor installment note is nonrecourse; and (b) the investor has no "equity" in the transaction and therefore no "profit motive."

11. After it is determined that the investor has entered into a real transaction with sufficient profit motive to support deductions under Code Sections 162 or 212, the next logical issue is whether the purchasers have made an equity investment or whether the transaction should be recharacterized as a financing in which the purchasers acquired no equity ownership interest in the property. Normally ownership of property is determined by examining which party to the transaction has the benefits and burdens of ownership. Although the Supreme Court's decision in *Frank Lyon Company* v. *United States*, 435 U.S. 461 (1978), is an uncertain precedent because of the many factors mentioned by the Court, I believe the case stands for the proposition that in a net lease transaction many of the benefits and burdens of the property may be shifted to the net lessee, and what is in question is whether the purported owner has the traditional attributes of a net lessor.

12. Some authorities believe that, as a result of accelerated cost recovery system depreciation and investment tax credit (when available) more accurate tests are (1) whether an investor obtains a reasonable after-tax return and (2) that this return can vary significantly as a result of changes in value of the property; *Frank Lyon Company* v. *U.S.*, *435* U.S. 461 (1978).

13. Section 74 of the Deficit Reduction Tax Bill of 1984 (adding Section 467 to the Internal Revenue Code) as passed by the Senate would virtually require a "commercial reasonableness" test. Provisions of H.R. 4170 (The Tax Reform Bill of 1984) would eliminate cash/accrual differences. Both of the bills were awaiting conference committee reconciliation at the time this article was written.

14. Proposed Treasury Regulation Section 1. 465-7(b)(1).

15. See Example 2 of Proposed Treasury Regulations Section 1.465-8(b)(4).