

Verne, B. Michael

From: [REDACTED]
Sent: Thursday, December 22, 2005 10:50 AM
To: Verne, B. Michael
Subject: Question about lease transaction

Hi Mike:

I'm looking at an acquisition of assets coupled with a long-term (20 years) lease of non-exempt real property assets. The deal has the following elements:

- 1) at closing (year 1), the purchaser will pay about \$2.6 million for the operating assets of a business located on the real property;
- 2) at closing, the purchaser will pay \$15 million for an option, which gives the buyer the right to buy the real property in year 20 for \$53 million;
- 3) over the 20 years following closing, the purchaser will lease the real property and make lease payments to the seller of \$375,000/month (\$90 million over the term of the lease -- this rate may be below the rate that the tenant could have obtained if the upfront option payment were not part of the overall deal); and
- 4) at the end of the lease term, buyer may (but is not required to) exercise the option (described in 2) above) to acquire the real property by payment to the seller of the \$53 million negotiated in that option.

I'd like to confirm that the transaction elements set forth above do NOT give rise to any obligation to file a Notification and Report Form because, taken together, the non-exempt elements do not meet the size of transaction test: (a) the operating assets and the option together would be valued at \$17.6 million, well below the \$53.1 million threshold; (b) the lease payments are at market rate (taking into account the initial \$15 million buy down of the rate); and (c) the final purchase of the real property, if exercised, would be below the filing threshold as well (which will no doubt be higher in 2025 than the \$53.1 million minimum we use today) and would not be aggregated with the initial purchase of the operating assets and option.

I've paused on this a bit because there is some thought that the lease may be accounted for as a capital lease, and while operating leases are not reportable, the status of capital leases under the HSR rules is less clear, and seem to hinge on whether beneficial ownership of the property is transferred to the lessee as a result of the lease. The following facts, I believe, are relevant to this analysis.

(u) The deal lawyers tell me that the lease is not intended to be an installment sale arrangement or a financing lease, but instead is

intended as a true lease.

(v) Title will remain with the seller throughout the lease term.

(w) Buyer is not required to make the final purchase in year 20, but may walk away.

(x) The proposed \$53 million purchase price suggests to me that the leased property will not have exhausted its useful life by the end of the lease term.

(y) The documents for this transaction have not yet been fully negotiated, and so the question of who will bear the risk of loss during the lease term is an open item. I would not be surprised if the risk of loss were to be determined by mandatory minimum insurance requirements on the property and on the operation of the business (many commercial leases have such provisions), but this has not been finally decided.

(z) The buyer will pay all taxes and make all repairs and improvements required for the leased property during the lease term, on terms customary for a triple net lease.

I would conclude that the seller retains the beneficial ownership of the property up until the date the option is exercised (if it ever is), and that, for HSR purposes, the lease payments should be excluded from the 2005 calculation of the value of the deal. As a result, none of the transaction elements, alone or in the aggregate, will give rise to a notification obligation.

Mike, I'm around today and tomorrow, and pretty much all of next week. Please give me a call or send me an email to confirm my conclusions and/or to discuss. My contact information follows.

Very best regards,

AGREE -
B. Michael
12/24/05



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