



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

October 6, 2005

Conditional Approval #706
November 2005

Joseph R. Bielawa, Esq.
Legal Department
J.P. Morgan Chase & Co.
270 Park Avenue, 39th Floor
New York, New York 10017

Re: J.P. Morgan Property Exchange Inc.; J.P. Morgan Property Holdings LLC; and
J.P. Morgan Aircraft Holdings Inc. (collectively, the "JPEX Entities")
Application Control Number: 2004-ML-01-0004

Dear Mr. Bielawa:

On October 13, 2004, the OCC approved the application of JPMorgan Chase Bank, New York, New York, to convert to a national banking association, JPMorgan Chase Bank, N.A. ("Bank"). Pursuant to the OCC's approval, the OCC permitted the Bank to retain the JPEX Entities for up to two years pending the OCC's determination of the permissibility of the JPEX Entities' activities under the National Bank Act. *See* Conditional Approval No. 658 (October 14, 2004). Based upon the information and representations you have provided, it is our opinion that the activities of the JPEX Entities are legally permissible for national banks and their operating subsidiaries. Therefore, for the reasons discussed below and subject to the conditions set forth herein, we conclude that the Bank may continue to conduct the activities engaged in by the JPEX Entities.

I. BACKGROUND

The JPEX Entities offer various services for Customers interested in engaging in capital gains tax-deferred exchanges of business or investment property under section 1031 of the Internal Revenue Code, 26 U.S.C. § 1031 ("section 1031"). Such transactions are called like-kind exchanges. For Customers considering engaging in a like-kind exchange, the JPEX Entities provide extensive financial and property advisory services.¹ These advisory services include reviewing a Customer's portfolio, advising the Customer on the structure of potential transactions, and referring the Customer to third-party providers (*e.g.*, real estate brokers).

¹ In addition, J.P. Morgan Aircraft Holdings Inc., provides qualified intermediary services for exchanges of aircraft. J.P. Morgan Property Exchange Inc., and J.P. Morgan Property Holdings LLC provide both qualified intermediary services for all other business and investment properties and exchange accommodation services for all business and investment properties, including real estate.

Once a Customer has decided to engage in a like-kind exchange, the nature of the JPEX Entities' services depends upon the type of exchange. In a *forward* like-kind exchange, the taxpayer will locate a buyer for the property he wishes to dispose of ("relinquished property") before finding a suitable property to acquire ("replacement property"). To qualify for tax-deferred treatment under section 1031, the taxpayer may contract with a qualified intermediary to facilitate the exchange by transferring interests in the relinquished property to a third-party, holding the proceeds from the sale of the relinquished property until the taxpayer identifies a suitable replacement property, and transferring interests in the replacement property to the taxpayer. The JPEX Entities act as qualified intermediary for like-kind exchanges when a Customer wishes to use this structure to complete the exchange.

A *reverse* like-kind exchange occurs when the replacement property is identified and must be acquired before the relinquished property can be sold. In that case, the taxpayer may use an exchange accommodation titleholder ("EAT") to acquire and hold the replacement property pending the sale of the relinquished property. The JPEX Entities serve as an EAT (the "EAT Services") for reverse like-kind exchanges that meet the requirements of I.R.S. Revenue Procedure 2000-37 (Sept. 15, 2000) ("Revenue Procedure").² The Bank represents that the EAT Services, and the reverse like-kind exchange transactions for which the EAT Services are provided, will be conducted in conformance with Revenue Procedure.³

The JPEX Entities conduct the EAT Services through a single-member limited liability company ("LLC") formed for each reverse exchange transaction.⁴ At the request of a Customer and after a full evaluation – including a credit risk rating – of the financial condition and prospects of the Customer, the JPEX Entities create a single-member LLC to serve as EAT for the Customer's reverse exchange. The EAT uses funds provided by the Customer to acquire

² The Revenue Procedure provides a safe harbor for certain reverse like-kind transactions. If a transaction satisfies the requirements of Revenue Procedure, then the I.R.S. will not challenge deferred tax treatment for that transaction.

³ The Revenue Procedure requires that the EAT must hold "qualified indicia of ownership" of the replacement property from the date of acquisition of the property by the EAT until the property is transferred to the taxpayer. The Revenue Procedure sets forth time frames for "safe harbor" reverse like-kind transactions. The most important timing requirement is that the EAT must transfer the replacement property to the taxpayer within 180 days of acquiring the qualified indicia of ownership. Thus, these "safe harbor" exchanges will last no longer than six months. Finally, the Revenue Procedure sets forth a number of permissible legal or contractual arrangements into which the taxpayer and the EAT may enter without affecting the tax-deferred nature of the transaction. Among the relevant provisions, (i) the EAT may also serve as a qualified intermediary for the exchange; (ii) the taxpayer may guarantee some or all of the obligations of the EAT, including secured or unsecured debt incurred to acquire the property, or indemnify the EAT against cost or expenses; (iii) the taxpayer may loan or advance funds to the EAT or guarantee a loan or advance to the EAT; (iv) the taxpayer may manage the property, supervise improvements of the property, or act as a contractor; (v) the taxpayer and the EAT may enter into an agreement that the taxpayer will reimburse the EAT for any variation in the value of the relinquished property.

⁴ In a reverse like-kind exchange transaction, the EAT first may acquire and hold an interest in either the replacement property or the relinquished property. For simplicity, we discuss only reverse transactions in which the EAT first acquires an interest in the replacement property. The same legal analysis applies to transactions in which the EAT first acquires an interest in the relinquished property.

“qualified indicia of ownership” in the replacement property.⁵ As a convenience to the Customer, the Customer’s provision of funds to the EAT may be via a non-recourse loan secured by the replacement property.

The Bank represents that the “qualified indicia of ownership” acquired by the EAT will be legal title to the business or investment property that will be the replacement property. However, such legal title acquired by the EAT will be severely circumscribed. Immediately upon acquiring such qualified indicia of ownership, the EAT enters into a lease with the Customer. The lease transfers the rights to occupy, use, and improve the replacement property to the Customer, and prohibits the EAT from transferring the qualified indicia of ownership to anyone other than the Customer. The lease obligates the Customer to pay all taxes on and costs to maintain the replacement property, and to pay for all desired improvements on the property. To the extent that the funds provided by the Customer to the EAT are in the form of a non-recourse loan, the Customer’s lease payments will offset exactly the EAT’s cost of carrying that financing.

The EAT continues to hold qualified indicia of ownership until the Customer can arrange for the sale of the relinquished property, a period not to exceed 180 days. When the Customer is prepared to sell the relinquished property, an exchange is effected: the relinquished property is transferred from the Customer to the third-party purchaser, and the replacement property is transferred from the EAT to the Customer. In the event the Customer fails to arrange the timely sale of the relinquished property, a mutual “put” and “call” arrangement ensures that the replacement property is nonetheless immediately transferred to the Customer.⁶

The proceeds from the sale of the relinquished property flow first to the JPEX Entities to cover the JPEX Entities’ fee and any expenses associated with the EAT Services, including repaying any non-recourse financing provided by the Customer to the EAT. The agreement between the JPEX Entities and the Customer contains guarantees and indemnities by the Customer that ensure that, should these proceeds be insufficient to cover such expenses, the Customer will provide the necessary additional funds. Any remaining proceeds then flow to the Customer.

Finally, the Bank represents that, because the EAT is acting solely as the Customer’s agent for all purposes except for federal income tax purposes, the activities of the EAT qualify for agency accounting under GAAP. Therefore, the assets of the EAT are held separate from the assets of the JPEX Entities and the Bank, are not reflected on any of their balance sheets, and are not subject to claims of their creditors.⁷

⁵ The Customer typically borrows the funds he provides to the EAT. If the Bank or one of its affiliated banks lends the necessary funds to the Customer, then the lending bank will comply with its commercial real estate lending standards, including obtaining an appraisal of the property.

⁶ In the event that the Customer defaults leaving the Bank holding the replacement property, the Bank represents that it will have policies and procedures in place to dispose of the property in a timely fashion.

⁷ See Financial Accounting Standards Accounting Board (“FASB”) Interpretation No. 46 (revised December 2003), “Consolidation of Variable Interest Entities.”

II. DISCUSSION

A. *Legal Analysis*

A national bank “may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority.” 12 C.F.R. § 5.34(e). The OCC previously has approved many of the activities offered by the JPEX Entities. Financial and real estate investment advisory services are permissible for national banks and their operating subsidiaries,⁸ and the referral of Customers to third-party providers is a permissible finder activity.⁹ Additionally, the OCC has approved national banks’ and their subsidiaries’ serving as qualified intermediary for like-kind exchanges.¹⁰

In Corporate Decision 2001-30, the OCC permitted an operating subsidiary to serve as an EAT for reverse like-kind exchanges, provided that the qualified indicia of ownership acquired in the replacement property constituted a form of ownership less than full legal title.¹¹ Therefore, the activities of the JPEX Entities are permissible, and the sole remaining issue is whether the acquisition of severely circumscribed legal title to real estate in those reverse exchanges involving real estate is prohibited by 12 U.S.C. § 29 (“section 29”). With respect to the acquisition of real estate, Corporate Decision 2001-30 concluded that acquisition of the proposed qualified indicia of ownership – a contractual right to purchase – was not prohibited by section 29. The Bank now requests that we permit the JPEX Entities, when serving as an EAT, to acquire the above-described severely circumscribed legal title in the replacement property. For the reasons below, we believe that under the specific facts presented by this case the acquisition of such a circumscribed interest is not prohibited by section 29.

⁸ See, e.g., Interpretive Letter No. 880, *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-373 (Dec. 16, 1999).

⁹ See, e.g., Corporate Decision No. 2003-10 (June 27, 2003); Interpretive Letter No. 824, *reprinted in* [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-273 (Feb. 27, 1998).

¹⁰ Corporate Decision No. 2001-30, (Oct. 10, 2001) (approving operating subsidiary to serve as qualified intermediary). While most like-kind exchanges are completed with a qualified intermediary, Internal Revenue Service regulations identify alternate means by which an exchange may be completed. For example, instead of a qualified intermediary, the taxpayer may use a qualified trust. 26 C.F.R. § 1.1031(k)-1(g)(3). The OCC has approved a national bank’s serving as trustee for such a qualified trust, provided the bank possesses trust powers. See Interpretive Letter No. 394, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,618 (Aug. 24, 1987). Although a qualified intermediary and a qualified trust both play the same general role – assisting in the completion of a successful like-kind exchange – they execute that role in a different manner. In Corporate Decision No. 2001-30, we concluded that the activities of a qualified intermediary are akin to the custodial and safekeeping functions that national banks traditionally have performed for their customers. National banks do not need trust powers to offer these escrow and safekeeping services. *E.g.*, Conditional Approval No. 267 (Jan. 12, 1998). Therefore, the JPEX Entities may serve as a qualified intermediary even if they do not have trust powers.

¹¹ Corporate Decision No. 2001-30, *supra* (acquisition as EAT of an interest in property that does not encompass the full right to possess, use, and convey).

Through its agreement with the Customer, the JPEX Entities assign away virtually all of the rights and responsibilities of ownership of the replacement property: the EAT may not occupy, use, or enjoy the property; the EAT may not freely transfer its interest in the property; the EAT does not share in any appreciation or depreciation in value of the replacement property; the Customer must pay all taxes on and costs to maintain the property; and, the Customer must pay for all desired improvements to the property. The JPEX Entities may only hold this circumscribed interest in the property for a short period of time and must have policies and procedures in place to dispose of the property if the Customer defaults.

After assigning away these rights and responsibilities of ownership, the JPEX Entities hold only bare legal title to the replacement property. The GAAP accounting rules further circumscribe this interest. Because the activities of the EAT qualify for agency accounting, the assets of the EAT are held separate from the assets of the JPEX Entities and the Bank, are not reflected on any of their balance sheets, and are not subject to claims of their creditors. Thus, it is the Customer, and not the EAT, that holds legal title for accounting purposes. We conclude that this type of interest in the replacement property by the EAT does not implicate section 29.¹²

This position is supported by the fact that the JPEX Entities' circumscribed interest in the replacement property would not be inconsistent with any of the purposes underlying the restrictions of section 29.¹³ The contractual relationship created between the LLC (as an EAT) and the Customer governs the transfer of the replacement property and essentially guarantees that the JPEX Entities will not lose money on the transaction or profit if property values escalate. Therefore, the risk remains with the Customer, and the JPEX Entities cannot be said to be speculating in real estate. And the JPEX Entities will hold the interest in the property for no longer than 180 days, so they cannot be said to be holding large amounts of real estate in mortmain.

B. Risk Assessment / Safety and Soundness Review

The foregoing analysis established that the activities performed by the JPEX Entities are part of the business of banking and so are within the activities authorized for national banks under 12 U.S.C. § 24(Seventh). Moreover, the acquisition of a severely circumscribed interest in real property as part of a reverse like-kind exchange transaction, as described above, is not prohibited by 12 U.S.C. § 29. However, for a particular bank to permissibly engage in these activities, the bank must have the systems and controls, and the general capacity, to conduct the activity in compliance with applicable law and in a safe and sound manner.

The Bank has that capacity with respect to the JPEX Entities' activities. The Bank has been providing the various like-kind exchange services, through the JPEX Entities, since the

¹² See *id.*, *supra*; Interpretive Letter No. 966, reprinted in [Current Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-489 (May 12, 2003) (noting that severely restricted nature of interest acquired in customer's relocating employees' residential real estate arguably did not implicate section 29).

¹³ For example, the Supreme Court in *Union National Bank v. Matthews*, 98 U.S. 621, 626 (1878), stated that the three purposes underlying section 29 were "to keep the capital of the banks flowing in the daily channels of commerce; to deter them from embarking in hazardous real estate speculations; and to prevent the accumulation of large masses of such property in their hands, to be held, as it were, in mortmain."

conversion and for several years before that time. The JPEX Entities have developed and implemented satisfactory policies and procedures to ensure that adequate documentation is maintained on file to support the credit review and approval process for each transaction; to ensure that all like-kind exchange transactions in which the JPEX Entities participate as comply with 26 U.S.C. § 1031 and that all reverse like-kind exchanges in which the JPEX Entities participate as an EAT comply with Revenue Procedure 2000-37; and to ensure that the JPEX Entities dispose of property in a timely manner should the Customer default on a transaction.

In the Bank's assessment of the risks involved in the EAT Services, the Bank identified the potential liability for environmental risks incident to the holding of real estate. The JPEX Entities have implemented satisfactory policies, procedures, and controls designed to mitigate the potential environmental risk, including policies and procedures that include specific guidelines for reviewing these risks in proposed transactions and obtaining approvals for the acceptance of such transactions.

The Bank recognizes the importance of the activities of the JPEX Entities, when acting as an EAT, qualifying for agency accounting under GAAP accounting rules. The Bank has obtained an accounting opinion that the proposed EAT Services will qualify for agency accounting under GAAP.

With these risk mitigation measures, the Bank believes it can ensure that the activities of the JPEX Entities are conducted in a safe and sound manner.

III. Conclusion

Based upon the foregoing, and the representations and commitments made in the application and by the Bank's representatives, we find that the activities of the JPEX Entities are permissible for national banks and their operating subsidiaries and, therefore, the Bank is legally authorized to retain the JPEX Entities,¹⁴ subject to the following conditions:

- (1) The JPEX Entities at all times must maintain, to the satisfaction of its examiner-in-charge, the risk mitigation policies, procedures, and controls described in the previous section.
- (2) At all times, the EAT Services conducted by the JPEX Entities must qualify for agency accounting under GAAP.

Please be advised that the above conditions of this approval shall be deemed to be "conditions imposed in writing by the agency in connection with the granting of any application or other

¹⁴ This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory, and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

request” within the meaning of 12 U.S.C. § 1818(b)(1).¹⁵

Our conclusion is based upon the information and representations you have provided. A material change in the facts may result in a different conclusion. If you have any questions, please contact Steven Key, Senior Attorney, Bank Activities & Structure Division, at (202) 874-5300.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller
And Chief Counsel

¹⁵ Because our review of the JPEX Entities was conducted as a continuation of our review of the Bank’s original conversion application, our decision here constitutes an addendum to Conditional Approval No. 658 (October 14, 2004), our decision on the original conversion application.