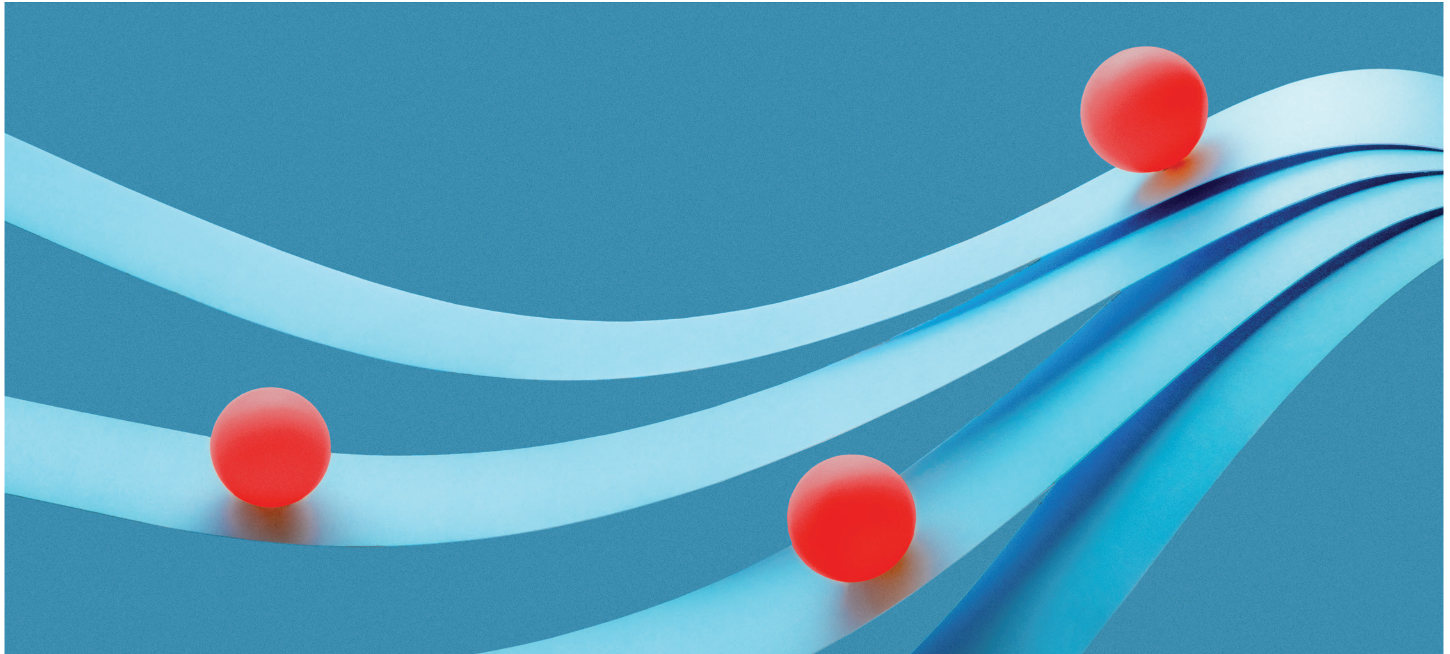
Key Equipment Finance



Navigating growth amidst rising rates

Have you considered a tax lease?

Raising interest rates to lower inflation is not new for the Federal Reserve. As a result, the ensuing ripple effect is fairly predictable. Cash flow constraints, higher prices, and increased borrowing costs typically undermine business growth. But recent tax law changes, coupled with continual rate hikes, could present more complicated — and costly — consequences in the form of higher tax bills and high-priced debt.

Regardless of whether your business is impacted by these changes, using a tax lease for capital investments can help foster sustainable growth in any economic climate. Here's how, in laymen's terms.

What's new, what's not, and why this matters

For years, businesses generally were able to deduct all interest expenses from their U.S. pretax income. In 2018, these deductions were limited to 30% of earnings before interest, taxes, depreciation and amortization (EBITDA).

Interest expense deducations

Beginning in 2022, further amendments to section 163(j) of the Internal Revenue Code prohibited companies from factoring depreciation and amortization into the earnings equation. In other words, interest expense deductions are now limited to 30% of earnings before interest and taxes only (EBIT).

Businesses with deductions near or equal to the 30% EBIT threshold should pay close attention to equipment acquisition. Combined with higher interest rates, this new limit will increase the after-tax cost of using a loan to finance equipment.

Net operating losses (NOLs)

For corporations with expiring net operating loss (NOL) carryforwards or other similar tax credits, depreciation deductions on purchased equipment reduce taxable income. While this law is not new, it has prevented businesses from fully using their tax credits in the past. Considering the current market environment, relying on NOL to lower your tax liability may not be a prudent strategy.

Why a tax lease?

Many businesses find using a tax lease to acquire equipment may result in the lowest after-tax cost. Here are two reasons:

1. **Tax leases effectively trade tax depreciation for lower payments and possibly a lower after-tax cost of financing.**

   In this scenario, the lessee forfeits the ability to claim bonus depreciation, but still receives the relative benefit in the form of lower payments and perhaps a lower after tax-cost of financing. Additionally, the after-tax cost of financing is less compared to loan payments included in the 30% deduction limit.

2. **Tax leases allow a business to deduct the full lease amount as an operating expense on its tax return.**

   Despite the new 30% EBIT limit, lessees can still deduct the entire lease payment (classified as an operating expense) on their tax returns.

Tax lease or equipment loan?

Acquiring new equipment with a tax lease can also help you improve cash flow and liberate working capital. A tax financing structure can be tailored to lower your monthly payments — significantly — compared to a traditional loan, as illustrated here:

		Traditional loan	Tax lease
$5MM of new assets	**60** months of payments	**$103,792** monthly payment	**$85,920** monthly payment

*Loan assumes a 9.00% interest rate and tax lease assumes a 20% FMV purchase option.

Equipment financing: bigger-picture benefits

The unique and valuable feature of a tax lease payment is the fact it can be considered an operating expense on a tax return and balance sheet. But any equipment financing structure can be a strategic business tool that allows a business to immediately acquire and employ equipment. All leasing structures can be instrumental in long-term planning while delivering significant short-term benefits as well. These benefits include:

Accounting and tax strategies

Leasing may help you manage certain financial ratios and minimize tax liability while achieving the lowest after-tax cost of ownership on a present-value basis.

100% financing and bundling

Leasing often requires little or no money down and provides flexibility to accommodate seasonal revenues. Plus, delivery and training costs can be included in your monthly payment plan. Furthermore, with a balloon or residual position at the end of the lease, your payment is based on the value of the equipment during the time it's in your possession.

Credit preservation

Financing allows your organization to stay nimble and optimize working capital. Immediate access to the equipment you need enables your assets to generate revenue while you pay for them over time. Meanwhile, you can use other credit facilities for their intended operational use—or take advantage of expansion and growth opportunities.

Technology and equipment management

Financing offers mid-term upgrades that allow you to enjoy current technology while avoiding the risk of owning obsolete assets. Plus, a customized financing agreement can include options to renew the lease, return the asset(s) or purchase them at the end of the term.

Grow your business now (we can help)

Will increasing interest expenses and reduced interest deductions lead to a higher tax bill in your organization? Possibly, and if so, a tax lease could be a viable alternative to a loan. But regardless of the answer to this question, the benefits of equipment financing help enhance cash flow in any economic condition.

To help determine the best equipment strategy for your organization, please contact us today.

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