KeyBank

Lease vs. Buy

What are the tax and financial effects ?

Comparing your financing options for equipment acquisitions

Obtaining the equipment necessary to grow and stay competitive continues to challenge agribusinesses. There are a number of important factors to consider when investing in new equipment—factors that can impact your overall financial health.

In the midst of rapidly changing markets and ongoing demands on capital, food processors and manufacturers face a demanding environment. Timely access to leading-edge technology and the potential for scalability play important roles in an organization's competitive positioning, making asset acquisition a high priority. However, there is no single, best answer to the question of how to pay for the equipment needed for an agribusiness to prosper.

Opportunities to employ lease financing in agribusiness are wide ranging, and a customized structure can help you reach your financial objectives. For example, there are options to optimize cash flow, help manage Alternative Minimum Tax (AMT) exposure and maximize temporary tax incentives. There are even options that facilitate equipment replacement and upgrades.

Here are some factors to consider when assessing your financing options:

Credit preservation

By avoiding depletion of valuable capital reserves or tapping into bank lines of credit, equipment financing allows your agribusiness to be more nimble. By using credit, you can acquire the equipment you need immediately, and these assets can generate revenue while you pay for them over time.

Flexible payment options can help your business optimize cash flow, address seasonal requirements and stay competitive. Equipment financing options often involve little or no down payment, and typical out-of-pocket costs such as software, delivery expenses and training can be bundled into a single financing arrangement.

Equipment management

If using the latest technology is important to your agribusiness, an equipment lease that offers mid-term upgrade and end-of-lease options can help you avoid the risk of owning obsolete equipment. You may also have the flexibility to either renew the lease, purchase the equipment or return the assets at the end of the term.

Tax savings

For many food producers and manufacturers, asset depreciation plays an important role in financial management. While the opportunity to benefit from depreciation exists for all types of equipment, determining whether your business can effectively use all of that depreciation requires careful consideration. This is especially important for equipment-intensive businesses. Full taxpayers in need of the sheltering effect of equipment depreciation will typically benefit from tax ownership of equipment, which can be accomplished with a loan, installment payment agreement and some types of leases. All of these options allow the agribusiness to deduct depreciation and interest charges from taxable income.

Food producers and processors with more complex tax situations may want to consider a tax lease, a type of financing that effectively trades tax depreciation for lower payments. Tax leases allow the entire lease payment to be deducted as an operating expense on a company's tax return.

The following is a high-level overview of factors to consider when you evaluate options for equipment acquisition:

Alternative Minimum Tax

Agribusinesses near to or already paying AMT should be aware of the implications of purchasing assets. A food producer in this situation cannot effectively use all the tax benefits associated with accelerated equipment depreciation, which can result in an increase in the after-tax cost of acquiring an asset. In contrast, a tax lease can minimize the creation of additional tax depreciation since the leasing company (lessor) records the equipment ownership and resulting depreciation. Because equipment leasing companies are able to more efficiently utilize the tax benefits associated with depreciation, the agribusiness lessee can enjoy the savings in the form of lower monthly payments made to the lessor.

Net operating losses / tax credits

A lease agreement is also advantageous for food producers and manufacturers with expiring Net Operating Loss (NOL) carryforwards or other similar tax credits. Depreciation deductions on purchased equipment reduce taxable income, sometimes preventing a business from fully using its tax credits. Leasing may allow you to maximize the use of the credits to lower your tax liability. In this manner, tax benefits are passed on to the agribusiness lessee in the form of lower payments.

Mid-quarter convention

The mid-quarter convention states that if a company acquires more than 40% of its assets during the fourth quarter, it must recalculate its depreciation expense using the mid-quarter convention tables. Most food producers and manufacturers attempt to avoid the mid-quarter convention by closely managing the amount of assets they purchase and place in service during the fourth quarter.

Leasing, however, allows your agribusiness the freedom to purchase the equipment it needs, when it's needed. By assigning the ownership role to the lessor, you avoid the fourth-quarter asset acquisition restrictions yet—because the lessor records the ownership of the assets—you still receive the full MACRS tax advantage in the form of lower payments. Leasing can be a helpful option for food producers when project delays or unexpected equipment replacement needs arise in the fourth quarter.

Summary: Weighing the benefits

Equipment financing can be used as a strategic tool: It enables you to acquire and employ assets immediately and help you achieve long-term financial and business goals. Whether your company's objective is to enhance cash flow or optimize tax savings—or both—an in-depth analysis of your equipment is necessary. Assessing your current and future asset needs in the form of a lease versus buy analysis will help determine whether a lease or loan is the better alternative.

To learn more about how to develop the most profitable asset acquisition strategy, consult with an equipment financing expert. In particular, seek a professional with a background in lease structuring in the agribusiness industry, one who is willing to take the time to understand your unique business goals and plans.

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