2017 BROUGHT THE FIRST MAJOR TAX CHANGE IN OVER 30 YEARS.

HOW WILL THE NEW TAX LAW IMPACT THE WAY YOUR BUSINESS LEASES OR FINANCES THE PURCHASE OF HEAVY EQUIPMENT?

Understanding Tax Code Changes

Major updates to the U.S. tax code don't happen often. But 2017 brought the first one in more than 30 years. The question is: How will the new law impact whether your business leases or finances the purchase of your heavy equipment? Edwin Green, tax director at Cat Financial, offered some thoughts.

Significant tax code changes impacting loans and leasing

First, the changes signed into law on December 22, 2017, are add-ons to the existing tax code, not a tax simplification. Nearly all the old tax rules still exist, but now there are new factors to consider. Certain tax provisions may affect your preference for leasing or financing.

The case for equipment purchasing ...

Immediate expensing of revenue-generating business assets is an important change that has a direct impact on the value of a lease versus a loan for heavy equipment. The relevant rules in the past required the cost of equipment purchases to be depreciated over multiple years, reducing the upfront benefit of taking out a loan to finance an equipment purchase. Under the new rules, you can now deduct the full cost of the equipment in the year you purchase it – a huge incentive to finance and buy.

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The cash flow impact of this change is significant, as you can now match the cash expense with a deduction. You can pay the lump sum – whether directly or through a loan provided by Cat Financial – and then own the equipment and gain the benefit of the deduction. When the alternative is leasing the equipment your business needs and paying rent on it for 3-7 years, it's clear to see how recent changes can push you toward a loan that helps you secure equipment and immediate, significant tax benefits all at once.

... and for equipment leasing

However, you also have to take into account new limits on the ability to use interest deductions. If your company averaged over $25 million in gross receipts over the past three years and is in a net interest expense position – meaning interest deductions are higher than interest income – your ability to take the interest deduction may be limited. If you are interest limited, then a lease may be more attractive.

Another point to take into account involves debt covenants with your bank. If you have an existing loan from a bank – a very common situation for an organization to be in – your loan document may limit your ability to incur additional debt.

Making your own decision

These tax code changes mean you need to review your next equipment acquisition with a fresh set of eyes. If you have the room financially, it may now make sense to secure a loan, purchase the machinery and receive the tax credit in the same year. If you have existing covenants with your bank, or if the limits on interest deductibility create too much of a drawback, leasing may be your best bet.

Cat Financial does not offer tax advice. Please consult your tax professional for guidance specific to your business.

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