Know your equipment lease and its tax implications

COLUMBUS, Ne. — Two basic types of equipment leases require different tax treatments, so be sure to understand the plan you're considering.

That's the advice from Ben Polzkill, marketing manager for Lindsay Credit Corp., located here.

The two types of plans are the true lease and the lease purchase agreement.

Polzkill said, "The difference between the two plans are confusing and can sometimes be misleading. If you understand what you're dealing with from the very beginning, you shouldn't have any problems."

A true lease meets all the Internal Revenue Service requirements for tax deductions. The guidelines for this lease type are (1) no equity can be established, (2) rentals are substantially equal, (3) only a qualified estimate or fair market value may be offered, (4) renewals of purchase options are available at fair market value, (5) lessor bears risk of ownership and (6) estimated useful life is the greater of two years or 10 percent over original lease term.

Under a lease purchase agreement, normally the investment credit is passed to the leasee, according to Polzkill. In addition payments are usually substantially higher.

"Usually this type of program offers a nominal purchase option at the end, that's the real tip-off when you're dealing with a conditional sales contract type lease."

Polzkill explained that "Under a lease purchase plan, payments cannot be deducted on tax returns. Depreciation is on the same basis as an outright purchase. Farmers cannot automatically just write off lease payments as the operating expense under the lease purchase This is the area you have to be careful about.

If the lease payment is written off as an operating expense and the IRS determines the plan is a conditional sales contract, you could be in line for penalties or additional tax payments.

He advises that when comparing lease plans for equipment be sure to find out what type of plan it is — a true lease or a lease purchase. Then, pick the one that fits your situation best. If you want to write your lease payment off as an operating expense, choose a low cost true lease. If you want to take ITC and depreciation, then choose a high-cost lease purchase plan.