# Farm equipment leases up sharply, reports USDA

WASHINGTON, D.C. — More and more farmers are leasing their equipment instead of buying.

A recent survey of 131 leasing companies indicates that the value of their outstanding agricultural leases rose 141 percent between 1979 and 1980. According to this survey, irrigation units are the most common type of farm equipment leased, followed by tractors and harvesting equipment, reports USDA's Economic Research Service.

Rising machinery prices, loan rates, and income tax brackets for some farmers make leasing attractive. The Economic Recovery Tax Act of 1981 grants advantages to corporations and banks that purchase rental equipment, a situation fostering desirable leasing terms for farmers.

Since leasing requires no downpayment, it frees that working capital for defraying the rapidly rising costs of production items such as fertilizer, pesticides, and machinery and repair costs. Because of IRS classifies lease payments as fully deductible business expenses, leasing increases the farmer's after-tax cash flow over the entire term of the lease.

With competition in the leasing market on the rise, lessors often pass some of their savings in investment tax credits, depreciation, and interest deductions to the lessee in the form of lower lease payments

Financial and operating leases are the two types currently in use There are no aggregate data specifying the extent to which each type is transacted in the farm sector.

The costs associated with both operating and financial leases are tax-deductible. However, the short period of use usually involved with an operating lease makes the lower capital investment much more important than any tax advantages. With financial leases, which entail longer-run use of equipment, the farmer carefully weighs the tax differences between leasing and ownership.

**For the Short Term...Operating Leases**

Operating leases are made for the short term, usually less than a year. For this reason, rates on an operating lease are often set on an hourly, daily, or weekly basis.

Besides offering flexibility, operating leases free lessees from the fixed costs of [illegible] as taxes, insurance, interest, and depreciation. Such costs per unit of time can be excessive if the equipment is only used for a very short part of the year, as is often the case with items such as cornheads.

Although under an operating lease the lessee is responsible for variable costs, including fuel and routine maintenance, he does not have to pay for repairs. The lessor incorporates fixed ownership costs into the lease payment, but the amount a farmer pays in this way - when leasing for short periods of time - is often less than his costs of ownership would be.

The outlook for operating leases appears promising. Should the farm sector become more dependent on export demand, total demand for farm output is likely to show more volatility. In order to add flexibility to their production schedules, farmers may need to use some farm machinery part-time through operating leases.

The expansion in individual farm size requires additional equipment. With parttime use through an operating lease, the farmer can avoid adding to the long-term debt he may already have incurred in purchasing additional farmland.

**For the Longer Term...Financial Leases**

Financial leases are usually extended for between 3 and 4 years, and the lessee is contractually bound for the entire term of the lease Financial leases are especially attractive because the payments are fully tax deductible, whereas with purchase loans, only the depreciation and interest portions of payments are tax deductible.

When buying, the farmer receives a 10-percent investment tax credit, which directly reduces his total tax bill. For farmers with higher tax liabilities, this credit declines in significance while the tax deduction on total lease payments becomes more significant.

Although financial leases often carry a higher implicit interest cost than comparable loans, the tax revisions under the Economic Recovery Tax Act of 1981 have reduced the after-tax costs relative to purchase loans The revisions have extended the maxi[illegible] of a lease from one-half of the useful life of the equipment to 90 percent of its useful life and have eliminated the limit on lease payments

For example, the extension of the maximum term has allowed lease payments to correspond to the amortization of principal and interest, which are fully tax deductible. Previously, the tax laws had limited the lease term to prevent it from serving as a disguised purchase.

Types of Equipment Leased by the Various Lessors, 1980

| Items Leased | Banks | Type of Lessor Captive percent of items leased | Independent |
|---|---|---|---|
| Tractors | 5 | 25 | 17 |
| Autos | 2 | 0 | 0 |
| Trucks | 3 | 0 | 7 |
| Irrigation equipment | 45 | 3 | 23 |
| Grain Storage and handling equipment | 12 | 1 | 10 |
| Harvesting equipment | 14 | 19 | 6 |
| Livestock buildings and equipment | 1 | 1 | 10 |
| Livestock | 0 | 25 | 21 |
| Implements and other machinery | 9 | 13 | 5 |
| Non production items | 9 | 13 | 1 |

Eliminating the limit on lease payments has allowed farmers to amortize repayment of the principal faster. Because under a lease contract these repayments are fully tax deductible, the lessee can realize larger tax savings during the early part of the lease when the net present value is highest.

This option can be advantageous to farmers in high tax brackets, even if they have an adequate cash flow to purchase the equipment. In addition, the variable interest rates on Production Credit Association loans mean much uncertainty about interest payments. By locking interest charges into a fixed rate, financial leases eliminate this uncertainty.

The outlook for financial leasing also appears favorable. The consolidation of farms into larger operations, as well as an increase in absentee owners with high off-farm incomes, tends to increase the average tax bracket of many farmers. While the Economic Recovery Tax Act of 1981 should slow this trend, it should still increase the tax advantages of financial leases. The continued volatility of interest rates at a high level should likewise enhance farmers' desire for the fixed-payment privilege financial leases offer.

**Incentives for the Lessors**

For the lessor, there are many advantages to leasing instead of selling The implicit rate of return on a lease often exceeds the effective rate of return on a loan.

Lessors can benefit from an investment tax credit on equipment purchased for leasing, and they can claim normal depreciation. Also, after a financial lease expires, lessors can often sell the equipment at more than book value.

Lessors of farm machinery are primarily independent commercial leasing companies, bank-affiliated lessors, participation lessors, and captive lessors affiliated with manufacturers of farm equipment.

The independent commercial leasing companies, which traditionally have not been heavily involved in farm equipment leasing, generate their own business. They often retain agents who locate customers. To ensure a sufficient volume of business to compensate for their high fixed costs, most commercial leasing companies lease the more expensive types of farm machinery, such as tractors and combines.

Participating lessors engage in joint loans, usually with small country banks. They provide expertise in exchange for a servicing fee, while the country bank originates the lease. The participating lessor often holds a minimum of 25 percent of the lease.

Small local banks have become very receptive to such

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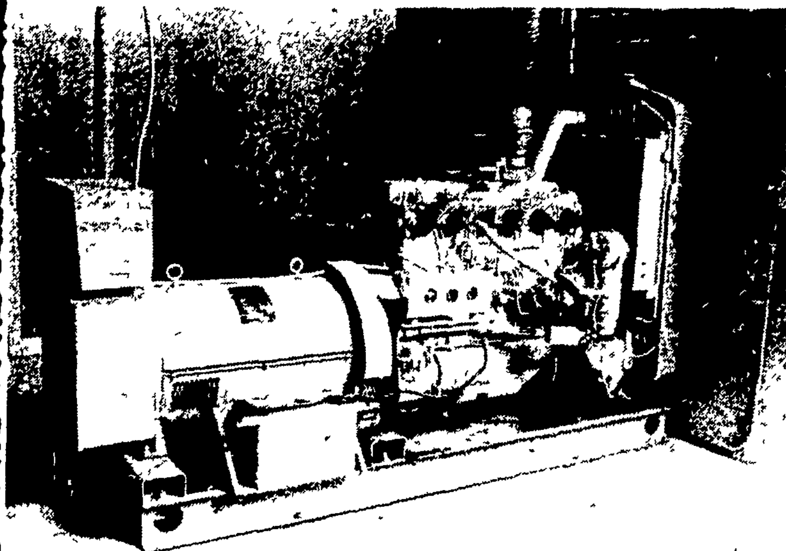

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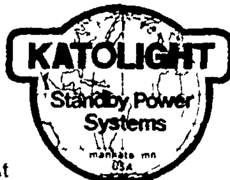


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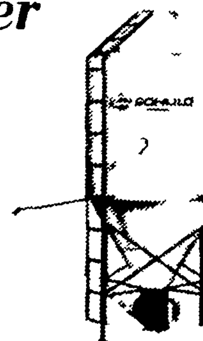

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