Lower Your Taxes by Leasing Your Equipment

One of the best reasons to lease equipment is that it can reduce the amount you'll have to pay in taxes.

The savings comes from being able to deduct your entire lease payment as an expense. When you own the equipment, you can only deduct the depreciation and interest expenses, but not the amount you're paying toward the principal. Even more, in the year you buy it, you can only deduct **half** of the normal depreciation.

Added savings come from the length of the typical lease, which is much shorter than the normal depreciation term allowed by the IRS. The shorter write-off period means you'll have a larger deduction each year, which translates into lower taxable income and decreased taxes.

Extra Benefit for 4th Quarter Purchases

If you plan to acquire a lot of equipment toward the end of the year, leasing looks even better.

The IRS has special rules for computing depreciation deductions when you purchase a large amount of equipment—over 40% of your equipment—during the last three months of the tax year. This "mid-quarter convention" only lets you deduct 1-1/2 months of depreciation for the equipment placed in service in the last quarter, even if you've been using it for the full three months. If you file quarterly estimated taxes, you could even find yourself needing to refigure prior tax estimates and adjust fourth quarter tax payments.

Depreciation deductions for other equipment placed in service that year are based on the number of quarters that it has been in service. But even so, total annual depreciation deductions often allowed under the mid-quarter convention are generally lower, resulting in lost tax benefits.

With the right kind of lease, though, you can simply deduct your lease payment as an operating expense and avoid the depreciation deduction issue altogether.

It's a good idea to consult with your accountant about the best financing alternative to lower your taxes, but here are some things to think about if you're considering leasing:

IRS Tax Guidelines

Sometimes it's difficult to decide whether a transaction is a true lease or a conditional sale, which affects how you account for it when it's time to pay your taxes. The IRS isn't specific on the rules, and decides each case independently. Generally, though, a transaction is considered a true lease if you follow a few simple guidelines.

1. The term of the lease shouldn't last longer than the property's economic life.

2. Your lease payments can only amortize the value of the equipment that is actually used, not necessarily its total value.

3. If you decide to buy the equipment at the end of the lease, you can't pay less than its fair market value.

4. You can't furnish any part of the cost of the leased equipment, such as trade-ins or down payments.

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For the type of lease that is right for you, please consult with your accountant.

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