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Tax Law Changes Affecting Equipment Leasing Companies

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The changes to the Internal Revenue Code of 1986 (the Code) under the Tax Cuts and Jobs Act (the Act) are quite favorable to equipment leasing companies. This memorandum is a brief summary of the most significant developments. It is not intended as legal advice, and you should consult your own tax advisors for additional information.

Reduction in Tax Rates

The Act substantially reduces income taxes on corporations, replacing the prior graduated rates, which had a 34 percent marginal rate for taxable income above $75,000 and a maximum 35 percent rate on taxable income above $10 million, with a single rate of 21 percent.

Extension and Expansion of Bonus Depreciation

The Act increases the bonus depreciation percentage to 100 percent, effective for property acquired and placed in service by the taxpayer after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft eligible for the one-year extended placed in service date under prior law). Thereafter, the applicable percentage decreases by 20 percent per year, i.e. the percentage is 80 percent for property placed in service during the calendar year 2023, 60 percent for property placed in service during the calendar year 2024, 40 percent for property placed in service during the calendar year 2025, 20 percent for property placed in service during the calendar year 2026, and is phased out entirely after 2026 (2027 for longer production period property and certain aircraft).

In addition, the Act makes bonus depreciation available for used property acquired in a taxable arm's length transaction, the first-time bonus depreciation has not been limited to new property. This means that compliance with the special rules for sale-leaseback and syndication transactions is no longer necessary in order to qualify for bonus depreciation.

Like-Kind Exchanges Eliminated

The Act repeals like-kind exchange treatment for all property except real property. However, with the bonus depreciation percentage at 100 percent the treatment of a transaction as a taxable sale and purchase of replacement property, rather than as a like-kind exchange, does not result in any adverse tax consequences because gain recognized in a taxable sale will be fully offset by the 100 percent bonus depreciation deduction for the replacement property.

Limitations on Interest Deductions

The Act includes limitations on the deduction of interest relating to a business activity. Generally, interest deductions may not exceed 30 percent of taxable income determined without regard to depreciation. This limitation applies to businesses with average annual gross receipts in excess of $25 million.

This limitation may impact leasing companies engaged in leveraged leasing. On the other hand, from the lessee's perspective it may enhance the advantage of leasing under a true lease, and claiming a full deduction for the rental payments, over a leveraged purchase of the same equipment if the interest is not fully deductible.

Each equipment leasing company should carefully review and revise its standard federal income tax indemnification provision to address the changes in the tax laws.

Should you desire to discuss the material contained in this update, or to request a review and revision of your federal income tax indemnification provision, please contact your regular Baker Donelson attorney, alert author Larry Ash, or a member of Baker Donelson's Equipment Leasing and Finance Group.