Equipment Financing Options Explained

Fair Market Value Lease

A lease whereby the owner/lessor provides 100% of the funds required to purchase equipment for lease to a user/lessee over a defined term. These leases are generally "True Leases" for tax purposes[1] (i.e. the lessor is considered owner and takes MACRS allowance deductions related to the equipment). For financial accounting purposes, fair market value leases are generally structured as Operating Leases for the lessee, although the lease may also be structured as a Capital Lease for clients who prefer on-balance sheet financing.

Lease Intended as Security

A type of loan equivalent whereby the owner/lessor provides 100% of the funds required to purchase equipment for lease to a user/lessee over a defined term. The agreement typically contains an end of lease purchase option at a fixed price less than the Fair Market Value of the asset and is not considered a "True Lease" for tax purposes.[1] The lessee is considered the tax owner and MACRS allowance deductions related to the equipment. For financial accounting purposes, these leases are considered to be Capital Leases by the lessee.

Non-Tax Operating Lease (Synthetic Lease)

A Lease Intended as Security which qualifies as an operating lease for lessee financial reporting purposes; but, which fails IRS "True Lease" criteria. Consequently, the lessee is eligible to utilize MACRS allowance deductions as if the transaction were a loan, while still maintaining good balance sheet management. Structurally, this type of transaction is fundamentally equivalent to a partially amortizing term loan with a balloon payment, some or all of which is satisfied from reliance on equipment value. Attractive low periodic rental payments are often achieved through a significant end of term residual position, which may be partially guaranteed by the lessee.

TRAC Lease

A lease agreement that requires a rental adjustment at the end of the lease term. The amount of this adjustment depends on the actual value of the vehicle as compared with the original estimated value of the vehicle upon which the lease payments were based. If the actual value is less than the estimated value, the lessee is required to pay the deficiency to the lessor as the final rental. If the actual value is greater than the estimated value, the lessor may pay to the lessee the surplus, which payment reduces the amount of the final lease payment.

Term Loan

A debt instrument secured by specific equipment, whether newly acquired or being refinanced. The borrower receives funding of up to 100% of cost/value from the lender and agrees to make principle and interest payments in regular installments. Interest rates may float or be fixed for the term. Loan covenants are typically not required under the terms of the loan.

Lease Line of Credit

Similar to a bank line of credit which allows a lessee to add equipment to a lease, as needed, under the same basic terms and conditions, without negotiating a new lease.

FASB lease accounting standards may impact equipment finance options.

[1] IRS Circular 230 Disclosure: To the extent this document concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law. You bear the responsibility for your own research and decisions. Always seek the advice of a qualified tax expert before making any tax decisions.

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