ELFA
EQUIPMENT LEASING AND FINANCE ASSOCIATION

EQUIPMENT LEASING AND FINANCE ASSOCIATION
1625 Eye Street NW
Suite 850
Washington, DC 20006
P 202.238.3400
F 202.238.3401
www.elfaonline.org

April 27, 2018

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
U.S Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Secretary Kautter:

On behalf of the equipment leasing and finance industry, ELFA is writing to request clarifying guidance on three areas of tax law affected by changes to the Internal Revenue Code (the Code) made by Public Law 115-97 (P.L. 115-97). All three requests are related to the changes made by P.L. 115-97 to the cost recovery system allowed for under the Code. The first involves treatment of purchases made at the end of a lease that is considered a true lease for tax purposes. The second relates to the retention of language dealing with lease syndications, a commonly used practice which provides for significant flexibility in capital formation. Lastly, we are requesting guidance on potentially onerous record keeping requirements for assets, especially long-lived assets.

Background on the Equipment Leasing and Finance Industry

Many capital-intensive businesses rely on leasing and financing to acquire the plant and equipment necessary to conduct business. In 2016, a projected $1.508 trillion was invested by U.S. businesses, nonprofits and government agencies in plant, equipment and software. Approximately 68%, or $1.034 trillion of that investment, was financed through loans, leases and lines of credit. The equipment leasing and finance industry is critical to capital formation in the United States.

End of Lease Treatment of Assets

P.L. 115-97 expanded the additional first-year depreciation deduction allowed for under Section 168(k), often referred to as bonus depreciation, to include used equipment whereas prior to 2018, it had been applied only to new equipment. (It should be noted that previous law included exceptions relating to sale-leasebacks and syndications, which were designed to facilitate these types of transactions.) This provision was enacted through a first-use test. The exact language states that property meets the test of this section if, “such property was not used by the taxpayer at any time prior to such acquisition.” In the simplest form this means that, for tax purposes, if a farmer buys a five-year old used combine today, the farmer will be permitted to claim 100% bonus depreciation and, accordingly, fully depreciate the combine in the 2018 tax-year.

For illustrative purposes we will utilize a farmer who leases a new combine, with a list price of $500,000, from Acme Agricultural Leasing for three years with a lease that is considered a true lease for tax purposes.

Prior to the passage of P.L. 115-97, the farmer and Acme would enter into a lease agreement and the farmer would use the combine during the three-year lease, remitting lease payments to Acme. Acme would retain ownership of the combine for tax purposes and claim 50% bonus depreciation in the first year of the lease. Acme would continue to depreciate the remaining basis according to depreciation schedules. If, at the end of the lease, the farmer wanted to buy the combine, the farmer would pay Acme the fair market value (FMV) of the combine, assume tax ownership of the combine and depreciate it according to the basis established by the FMV price of purchase. Alternatively, the farmer could return the tractor to Acme, who could either lease it again or sell it.

Under current law, using the same illustrative example, the farmer and Acme would enter into a three-year true lease agreement for a new combine and the farmer would use the combine during the three-year lease, remitting lease payments to Acme. Acme would retain ownership of the combine for tax purposes and would fully depreciate the $500,000 combine in the first year of the lease. The issue arises if, at the end of the lease, the farmer wishes to purchase the combine at the end of the three-year lease at fair market value.

During the three-year lease, the farmer is clearly physically using the combine in the pure sense of the word "use." However, the farmer has not "used" the combine in the tax sense of the word in that the farmer has not depreciated the asset. ELFA believes that Congress intended the expansion of Section 168(k) to be applied broadly, and believes that a taxpayer, in this case the farmer, should be eligible to claim bonus depreciation if the taxpayer has not previously depreciated the asset. Thus, in this situation, we believe that during the term of the original lease, the owner of the asset for tax purposes, Acme, would be able to fully depreciate the asset in the 2018 tax year. Then, in 2021, at the end of the lease, if the farmer decides to purchase the combine at fair market value, let's say for $250,000, the farmer would be eligible to fully depreciate the combine with a basis of $250,000, and Acme would pay tax on the gain from the sale.

Any other reading of the law would lead to perverse economic situations where at the end of a lease, a taxpayer purchasing a piece of equipment that they had been leasing would be treated differently from an economic perspective than that same taxpayer purchasing a piece of equipment of the same value from a third party. Inevitably, this would lead to economically inefficient transactions, where a lessee is returning equipment to a lessor that they would like to purchase and then purchasing an identical piece of equipment (save for the serial number) from a third party, subjecting the transaction to significant transaction costs including, but not limited to, closing costs on the new transaction and remarketing costs for the lessor when they attempt to either lease the asset again or sell the asset.

Additionally, there are other areas of the Code where Congress has specifically excluded classes of transactions from being eligible for bonus depreciation, e.g., leasing to tax exempt entities in specific situations. Since there is no legislative history supporting such an exclusion here, ELFA believes that it was the intention of Congress to allow taxpayers to utilize bonus depreciation if they purchase an asset at fair market value at the end of a lease and have not previously claimed depreciation on that asset.

Accordingly, ELFA is requesting that the Treasury Department and the Internal Revenue Service issue a statement or clarifying guidance indicating that for the purposes of utilizing bonus depreciation, "first use" is defined as claiming tax depreciation on the asset. Thus, if a taxpayer has not previously claimed depreciation on an asset, they are eligible to use bonus depreciation on that asset should they purchase the asset and assume tax ownership.

Lease Syndications

Prior to the passage of P.L. 115-97, the Code included a provision, which is still codified at Section 168(k)(2)(E)(iii), designed to encourage efficient capital formation by allowing bonus depreciation when leased assets were sold, and the lease assigned to an unrelated party, within three months of the asset first being placed into service, a process sometimes referred to as lease syndication.

This three-month rule language was left unchanged by P.L. 115-97; however, ELFA believes that the need for this language is obviated by the expansion of bonus depreciation to include used equipment. That is, under prior law, absent the three-month rule, bonus depreciation would not have been available in cases where a lease was syndicated, i.e., originated by one party and sold to another party in a short period of time. Under current law, bonus depreciation is available for used equipment, meaning that there is not a limitation if one lessor sold the asset and the accompanying lease to another lessor.

ELFA is requesting that the Treasury Department and the Internal Revenue Service issue a statement or clarifying guidance indicating that when determining whether bonus depreciation applies, the portions of the Code that provide for bonus depreciation for used equipment are still applicable after three months. This would mean that the purchaser of an asset, and the assignment of any associated lease, at any time would still qualify for bonus depreciation as long as the other tests are met. Any other interpretation would mean that leased assets are being put at a disadvantage relative to non-leased equipment in the resale market.

Record Keeping Requirements

A significant portion of assets that are leased or financed are long-lived assets such as railcars and containers. Some of these long-lived assets are not routinely provided with static identifying numbers and are often tracked utilizing an identifier that may change when ownership changes. In light of this, ELFA is requesting some reasonable safe harbor for asset tracking that would alleviate potentially burdensome record keeping requirements that would be associated with tracking a taxpayer's historical "use" of an asset. We believe a safe harbor that limits the assessment of prior use to the previous two tax years would strike a balance between onerous asset tracking requirements and the public policy goals of discouraging the "churning" of assets to reset a taxpayer's basis in the property. (Although it should be noted that with the elimination of like-kind exchanges, the potential for such churning has already been dramatically reduced.)

For most longer-lived assets, leases commonly run for significantly longer than two years. Accordingly, so as long as the asset being purchased was owned by an unrelated entity prior to re-appearing in the equipment finance market, if a two-tax-year safe harbor was in place, the need to assess whether the purchaser has used that specific piece of equipment in the past two years would largely be mooted.

Lastly, ELFA is aware that, for many long-lived assets, lease terms may extend beyond the period that bonus depreciation will be in effect. However, Section 168(k) is an area of the Code that has historically been extended or has been reinitiated even after periods of expiration, and this safe harbor will be useful if the history of bonus depreciation repeats itself.

Thank you for your consideration of these matters. Please let me or ELFA's Vice President for Federal Government Relations, Andy Fishburn, know if ELFA can provide additional materials or information that would inform your consideration.

Sincerely,

Ralph Petta

Ralph A. Petta
President and CEO