

# Leasing 101 - About Leasing

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Terms And Definitions  
Lease

A lease is a contractual arrangement in which a leasing company (lessor) gives a customer (lessee) the right to use its equipment for a specified length of time (lease term) and payment (usually monthly). Depending on the lease structure, the customer can either purchase, return, or continue to lease the equipment at the end of the lease term.

## Tax Structures

For the business owner, there are two primary types of leases that determine tax benefits: 1) operating or true leases and 2) capital or finance leases. A lease is usually considered a true lease if, at the end of the lease term, the lessee has the option to purchase the equipment at fair market value (FMV). Conversely, if the lease agreement contains a bargain purchase option, such as \$1 or 10 percent of the original purchase price, it would be treated as a finance lease. Always consult a tax advisor to determine lease treatment and for advice on which lease structure is most appropriate for you.

## Types Of Leases

### \$1 Buyout

At the end of the lease term the lessee can purchase the equipment for one dollar. This structure is ideal if the useful life of the equipment is expected to be greater than the lease term. A \$1 buyout lease normally qualifies as a capital lease or finance lease. (Consult a tax advisor to verify proper tax and accounting treatment.)

### 10 Percent Buyout

Under this structure, the lessee has the option to purchase the equipment for 10 percent of the original cost at the end of the term and the payment is lower than that in a \$1 buyout lease. This structure is ideal if the useful life of the equipment may be longer than the lease term and the lessee wants a fixed purchase price. A 10 percent buyout lease usually qualifies as a capital or finance lease. (Consult a tax advisor to verify proper tax and accounting treatment.)

### Fair Market Value Buyout (FMV)

This lease structure normally provides the lowest lease payment and normally qualifies as an operating or true lease. (Consult a tax adviser to verify proper tax and accounting treatment.) At the end of the term, the lessee has the option to purchase the equipment for its fair market value as determined at that point in time. This structure is ideal if the expected useful life of the equipment is equal to the lease term, the lessee desires the lowest monthly payment possible or the lessee desires the maximum tax benefits.

Under all types of leases the lessee as the option to purchase the equipment, return the equipment or extend the lease at the end of the term.