

Should You Buy or Lease Your Business Assets?

One of the questions most often asked to me by my business clients is about owning or leasing business assets. This is because business owners often struggle with the issue of whether it is better to buy or to lease business assets such as vehicles, equipment, space, etc. Unfortunately, there is no one right answer. Rather, a business owner must look at a number of factors.

In many instances, an outright purchase of an asset makes more economic sense than a lease. A “lessor” who leases an asset to a business takes a risk, but also wants to make a profit, so risk and profit considerations are built into the lease price and paid by the “lessee” (your business). Obviously, a business owner can eliminate the lessor’s profit by purchasing the asset directly.

When Leasing Makes Sense

There are many situations in which the business owner is better off to lease an asset. Cash flow concerns may make leasing attractive. A lease generally requires less up-front cash and lower monthly payments, which can free up cash flow for other business needs.

Leasing also makes sense when an asset is only needed for a short period of time. Short-term leases work well for short-term asset needs and may be a smart decision when it is not known how long the business will need the asset. Another reason to lease is to avoid the risk associated with owning an asset.

Many business assets, especially high-tech equipment, are likely to decrease in value quickly. Many business owners are unwilling to assume this risk. A lease allows the business to pass this risk on to the lessor.

When Buying Makes Sense

In general, it is more advantageous to purchase rather than to lease business assets. Purchasing assets will eliminate the lessor’s profit, resulting in a lower overall cost for the business. Also, the law requires fewer disclosures for leases than for purchase loans, and lease agreements may be more complicated than purchase agreements or may contain undesirable limitations. Certain purchased assets (such as buildings) may provide equity for the business, and, over the long run, purchased assets should allow the business to retain more profits.

Weigh Tax Considerations

When determining whether it makes more sense to buy or to lease, a business must consider the tax ramifications. This is especially true if the business is looking at purchasing a “luxury automobile” that is subject to special depreciation and lease expense limits. Congress passed tax provisions a few years ago that limit the amount of depreciation that can be taken on many vehicles.

Similarly, there are some “income inclusions” that apply to more expensive vehicle leases. The amount reduces the lease expense deduction. Generally, the income inclusion rules are not as bad as the depreciation limitations. In other words, leasing can have a tax advantage over purchasing a luxury vehicle.