



Glossary Of Equipment Leasing Terms

Accelerated Cost Recovery System (ACRS)

The depreciation schedule of the Economic Recovery Tax Act of 1981 (ERTA), modified by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), that allows faster write offs of plant and equipment is classified as 3,5, or 10 years property. The accelerated cost recovery system (ACRS) replaced the asset depreciation range (ADR) system which was built on the concept of useful life.

Accelerated Depreciation

Any depreciation method that allows for greater deductions or charges in the earlier years of an assets depreciable life, with charges becoming progressively smaller in each successive period. Examples would include the double declining balance and sum-of-the-years digits methods

Add-On

A transaction to add related equipment/software to an existing lease. Typically this term is used when the new equipment is financed using the same lease structure (i.e. Fair Market Value, \$1.00 Purchase Option, Fixed Purchase Option, etc.)

Advanced Lease Payment(s)

The payment or payments made at the initiation of the lease contract, i.e. first rental payment or first and last rental payments.

What factors are used to determine credit worthiness of the business?

The length of time in business, references from bank and trades, Dunn & Bradstreet and credit bureau ratings.

Authorized Signature

A signature by a person authorized by a company to obligate the company on a long-term lease. An authorized signer will usually be substantiated by the Corporate Resolution which specifies who can sign and what his/her responsibilities may be.

Bargain Renewal Option

A lease provision allowing the lessee, at this option, to renew the equipment lease for a rental rate predetermined at lease inception, that is substantially lower than the expected fair market value at the date the option can be exercised.

Basis Point

One one-hundredth of a percent (.01%)

Broker

A broker acts as the middle-man between the lessee (the user of the equipment) and the full service leasing company that ultimately provides the credit approval, documentation, funding, and billing.

There are many leasing companies that act as brokers and receive a fee for their work. There are fewer full service leasing companies that have the ability to hold and service their leases throughout the entire term of the lease. The full service lessor provides greater control for the lessee and/or vendor in the event the lessee wants to upgrade or early terminate their lease. Since there is no middleman, doing business directly with a full service lessor usually results in a lower lease rate for

the lessee and a higher sale price for the vendor.

Capital Lease

A lease that meets at least one of the criteria outlined in paragraph 7 of FASB 13 and, therefore, must be treated essentially as an installment purchase for book accounting purposes. The four criteria are

Title passes automatically by the end of the lease term.

Lease contains a bargain purchase option

Lease term is greater than 75% of estimated economic life of the equipment

Present value of lease payments is greater than 90% of the equipment's fair market value

A Capital Lease is treated by the lessee as both the borrowing of funds and the acquisition of an asset and corresponding liability (lease payable). Periodic lessee expenses consist of interest on the debt and depreciation of the asset

Captive Lessor

A leasing company that has been set up by a manufacturer or dealer of equipment to finance the sale or lease of its own products to its customers.

Certificate of Delivery and Acceptance

A document that is signed by the lessee to acknowledge that the equipment to be leased has been delivered and is acceptable.

Closed End Lease

A true lease in which the lessor assumes the depreciation risk. The lessee bears no obligation at the end of the lease. This term is used to distinguish the lease from an open-end lease.

Coterminous

Two or more leases that end at the same time. A Coterminous Addendum can be used allowing you to add equipment to an existing lease, adjusting the payments to reflect the addition. Both the original lease and the addendum will terminate at the same time.

Cross Corporate Guaranty

A guarantee by one corporation to pay the lease obligations of another corporation.

Default

If a lessee does not comply with the terms of the lease, a default occurs. Generally, after a default, the lessor can exercise all of its rights under the lease to repossess the property and seek money damages.

Depreciation

A method for determining the useful life of a piece of equipment and for costing its value over the years of its active use. The total depreciation expense is equal to the difference between the initial cost of the unit and its estimated residual or salvage value. When divided over the years of the equipment's usefulness, this periodic expense can be deducted from income taxes each year.

Direct Finance Lease

Same as a capital lease except this accounting classification only applies to a lessor.

Discount Rate

A certain interest rate that is used to bring a series of future cash flows to their present value in order to state them in current, or today's dollars. Use of a discount rate removes the time value of money from future cash flows.

Dollar Buyout

Assuming that the lessee is not in default, an option at the end of the lease to buy the leased property for \$1.00

Early Termination

Early Termination of a lease occurs when the lessee pays off the balance of the lease prior to its maturity date or returns the lease equipment to the lessor prior to end of the lease term as permitted by the original lease contract or subsequent agreement. At times this may result in a penalty to the lessee.

Estimated Useful Life

The estimated time period leased equipment is expected to be useful. Estimated useful life is used to calculate the maximum allowable term of a "tax-oriented lease".

Estimated Residual Value

For purposes of calculating the maximum allowable term of a "tax-oriented lease", this is the "fair market value" of the lease equipment at the end of the lease term, calculated in constant dollars excluding inflation or deflation.

Exemption Certificate

A document exempting a lessor from paying sales tax on the equipment being leased. A lessor may be buying the equipment for "re-sale" as would a vendor/supplier, while a lessee may be tax exempt for other reasons, i.e., non-profit entity or a bank.

Fair Market Value Purchase Option

An option to purchase leased property at the end of the lease term at its then fair market value. The lessor does not have the ability to retain title to the equipment if the lessee chooses to exercise the purchase option

FASB 13

Statement number 13 of the Financial Accounting Standards Board (FASB) which establishes standards for lessees' and lessors' accounting and reporting for leases. This includes the characterization of a lease as an operating lease or capital lease for the lessee's purposes. A company's assets, liabilities and net income will differ depending on how it chooses to structure its leases. The provisions of FASB 13 derive from the view that a lease that transfers substantially all of the benefits and risks of ownership should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee (a capital lease) and as a sale of financing by the lessor. Other leases should be accounted for as the rental of property (operating leases).

Financial Statements

Accounting statements that provide specific information about a company's financial position. They include the Profit & Loss Statement, also know as the Income Statement, the Balance Sheet, and the Statement of Cash Flows. Financial statements can generally be audited by an outside CPA firm or be unaudited and, thus, prepared by the company.

Financing Statement (UCC-1)

A standardized form recorded with the Secretary of State and/or County Clerk to perfect a lien under the Uniform Commercial Code by notification to all interested parties. Used with some financing leases to protect lessor's interest in the equipment.

Finance Lease

A lease used to finance the purchase of equipment; not a true lease. Finance leases are generally considered to be capital leases from an accounting perspective and non-tax leases from a tax perspective.

Fixed Purchase Option

An option given to the lessee to purchase the leased equipment from the lessor on the option date for a guaranteed price. Both the date and the price must be determined at the inception of the lease. A typical fixed purchase option is 10% of the original cost of the equipment.

Full Payout Lease

A lease in which the total of the lease payments pays back to the lessor the entire cost of the equipment including financing, overhead, and a reasonable rate of return, with little or no dependence on a residual value.

Interim Rent

Interim rent is a one-time daily rental charge for a period of time between the day the equipment is delivered/accepted and the first invoice date. It is a partial payment for using the equipment during a partial month, and will be billed to the lessee on the first invoice.

Lease

A contract through which an owner of equipment (the lessor) conveys the right to use its equipment to another party (the lessee) for a specified period of time (the lease term) for specified periodic payments.

Lease Rate (Monthly Payment)

The periodic payment to a lessor for the use of assets.

Lease Schedule

A schedule to a Master Lease Agreement describing the leased equipment, rentals and other terms applicable to the equipment.

Lease Term

The fixed term of the lease.

Leasing

Leasing is a tax oriented method of gaining the use of an asset that can produce more income or benefits than the cost. A lease can be a method by which a client can obtain either use and/or ownership of an asset while matching a payment schedule to a predetermined budgetary allotment.

Leasing Line

A maximum amount of funding designated by the lessor for a lessee to use over a fixed commitment period.

Lessee

A party who makes use of property owned by another party (the lessor) and pays the lessor, usually in the form of rentals, for that use.

Lessor

Company or leasing entity that is the owner of the leased equipment for accounting, tax, or commercial law purposes.

Master Lease

A continuing lease arrangement whereby additional equipment can be added from time to time merely by describing that equipment in a new lease schedule. The original lease contract terms and conditions apply to all subsequent schedules. In contrast to a lease contract for a single transaction involving a specific unit of equipment, a Master Lease is essentially a line of credit to draw from over time in order to purchase equipment.

Municipal Lease

A lease designed to meet the special needs of state and local governments. The lease contains a non-appropriation clause which states that the only condition under which the entity may be released from its payment obligation is when legislature or funding authority fails to appropriate funds. Since the lessee is a municipality or an organization supporting the government, it is exempt from paying federal income taxes. For this reason, the IRS does not charge the lessor income taxes on leases to these customers.

Net Lease

A lease where payments paid to the lessor do not include insurance, taxes and maintenance, which are paid separately by the lessee .

Off Balance Sheet Financing

A lease that qualifies as an Operating Lease for the lessee's financial accounting purposes. Such leases are referred to as off-balance sheet financing due to their exclusion from the balance sheet asset and debt presentation, except for that portion of the payments that is due in the current fiscal period. Full disclosure of such transactions is typically made in the auditor's notes to the financial statements. Periodic payments are recorded as expense items on the lessee's income statement.

Operating Lease

A lease which is treated as a true lease (as opposed to a loan) for book accounting purposes. As defined in FASB 13, an operating lease must have all of the following characteristics:

Lease term is less than 75% of estimated economic life of the equipment

Present value of lease payment is less than 90% of the equipment's fair market value.

Lease cannot contain a bargain purchase option (i.e. less than the fair market value).

Ownership is retained by the lessor during and after the lease term.

An operating lease is accounted for by the lessee without showing an asset (for the equipment) or liability (for the lease payment obligations) on his balance sheet. Periodic payments are accounted for by the lessee as operating expenses of the period.

Personal Guaranty

The guarantee of someone to be individually responsible for the obligations under the lease. Generally, when financing closely held subchapter S companies and small businesses, a leasing company may ask for a personal guaranty as a way to insure that the lease payments will be made.

Purchase Option

An option given to the lessee to purchase the equipment from the lessor, usually as of a specified date.

Renewal Option

Lessee's option to renew a lease contract when it ends.

Residual Value

The book value that the lessor depreciated a piece of equipment down to during the lease term, typically based on an estimate of the future values, less a safety margin.

Sale and Leaseback

An arrangement where equipment is purchased by a lessor from the company owning and using it. The lessor then becomes the owner and leases it back to the original owner, who continues to use the equipment.

Synthetic Lease

A synthetic lease is basically a financing structured to be treated as a lease for accounting purposes, but as a loan for tax purposes. The structure is used by corporations that are seeking off-balance sheet reporting of their asset based financing, and who can efficiently use the tax benefits of owning the financed asset.

Step Lease

A lease where the rent may change during the term of the lease. The change is known at lease inception and is agreed by both the lessor and the lessee. Often a step-up lease allows the lessee to pay less initially and more later in the term. A Step Down Lease is the opposite. The lessee pays more initially and the payment amount decreases over the term of the lease.

Tax Lease

A generic term for a lease in which the lessor takes the risk of ownership (as determined by various IRS pronouncements) and, as the owner, is entitled to the benefits of ownership, including tax benefits.

Term

The length of time a lease agreement will remain in force. The rules of an agreement as supplied on a rental or lease contract between the customer (lessee) and the lessor. The terms of the contract will govern such things as the length of the agreement, rules of proper cancellation of the agreement, renewal terms, and charges for breach of the contract.

True Lease

A type of lease under which ownership of the equipment remains with the lessor. To qualify as a true lease for tax purposes, the Internal Revenue Service states that

- Title must remain with the lessor;
- The rental payments must be competitive with industry rates, represent payment for use of the equipment and have a rate that does not vary appreciably with or without purchase option;
- The option to purchase price must not be less than the fair market price at the lease's expiration date;
- Equity cannot be allowed on rental payments. For tax purposes, the total monthly payments can be deducted.

UCC Financing Statement

A document, under the UCC, filed with the county (and sometimes the Secretary of State) to provide public notice of a security interest in personal property.

Upgrade

To trade in leased equipment for a newer, more advanced model during the lease term.

Useful Life

The period of time during which an asset will have economic value and be usable. The useful life of an asset is sometimes called the economic life of the asset. To qualify as an operating lease, the property must have a remaining in useful life of 25% of the original estimated useful life of the leased property at the end of the lease term, and at least life of one year.

Use Tax

Many states charge a "use" tax in lieu of a sales tax when equipment is leased. So instead of paying a sales tax for purchase of the leased equipment, taxes are collected by the lessor as a percentage of the rentals over the lease term.

Vendor

A entity that provides leased property to customers.