Capital Markets Accounting Developments Advisory
Financial Instruments and Credit Group (FICG)

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The Obama Administration's call for 100 percent expensing of qualified investments could incentivise leveraged leases and sale-leaseback transactions.

Overview

On September 8, 2010, President Obama proposed that Congress approve legislation to provide, among other things, the 100 percent expensing of qualified investments beginning September 8, 2010 through 2011. In short, this is viewed as a benefit to taxpayers because it would allow taxpayers to reduce their taxable income by the cost of the investments in the first year rather than spreading the depreciation expense over multiple years.

Under the Obama Administration's proposal, companies could fully deduct, in the first year of ownership, qualified capital investments made from September 8, 2010 through December 31, 2011. This proposal could potentially accelerate tax deductions for capital investments by roughly $200 billion over the next two years. Congress had previously approved a 50 percent bonus depreciation provision for 2008 and 2009, and the Administration proposed to extend that bonus depreciation measure to the end of 2010. On September 16, the Senate voted 61 to 38 to approve small business legislation that includes a one-year extension of bonus depreciation.

PwC FICG Observation: In today's environment, many market participants cannot utilize the benefits of the proposed accelerated depreciation because they currently do not have enough taxable income to offset such depreciation. Such taxpayers could find that deferring depreciation deductions over the life of the asset might prove more beneficial, particularly if they are concerned with preserving the lifespan of net operating losses.

Opportunities for Leasing Transactions

If companies do not have enough taxable income to take advantage of accelerated depreciation, they often look to the leasing industry for solutions. In short, if a company cannot utilize the benefits of accelerated depreciation, a transaction can be structured where a third party or group of investors acquires the asset and lease it to the company. The company benefits because the lessor can pass on the benefit of the accelerated depreciation to the company in the form of lower lease payments; likewise, the lessor benefits because it's after tax return is increased from the depreciation acceleration. These transactions are often referred to as leveraged leases or sale lease-back transactions.

PwC FICG Observation: The proposal to allow 100% depreciation in the first year, should give rise to interest in leveraged lease transactions and the leasing industry in general. Companies that are running at a net operating loss will be most interested in leasing structures as it will allow them as lessees to benefit from the 100% depreciation even though they might not have benefited had they owned the asset directly.

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