

The Honorable Jim Gerlach
U.S. House of Representatives
Washington, DC 20515

The Honorable Linda Sanchez
U.S. House of Representatives
Washington, DC 20515

Dear Representatives Gerlach and Sanchez:

On behalf of the \$725 billion equipment finance industry, the Equipment Leasing and Finance Association (ELFA) respectfully submits the attached issue papers regarding tax reform generally, the importance of cost recovery and interest deductibility, and tax neutrality with respect to the purchase, finance, or lease decision for capital expenditures.

ELFA members finance the acquisition of all types of capital equipment and software including office equipment, IT and medical equipment, agricultural and construction equipment, railcars, and barges. Leasing and financing of equipment provides American business a critical cash-flow management tool and offers flexible choices that can work with the diverse objectives of most businesses. A brief description of the attached issues papers is set forth below.

Comprehensive Tax Reform

ELFA's Board of Directors passed a Policy Statement on Tax Reform at their October 2012 meeting. The statement calls on tax reform proposals to promote economic growth, competition, fairness and predictability. It also promotes specific values of the equipment leasing and finance industry such as: maintaining cost recovery and interest deductions; treating owner-lessors and owner-operators in a tax neutral manner; providing level playing fields for lessors and other financial providers; maintaining the tax-exempt treatment of state and local government obligations; and promoting a competitive international tax system.

Cost Recovery and Interest Deductibility

It is a long standing principle in the U.S. tax code that we tax income, and that income is broadly defined as revenues less expenses. In order to remain competitive in world markets, U.S. capital intensive industries must constantly replace and upgrade their plant and equipment because of wear and tear, as well as economic and technological obsolescence. Cost recovery (depreciation) and interest deductions reflect the cost of a taxpayer's investment in plant and equipment and the tax code should allow tax deductions over time for these significant business expenses.

Providing a Level Playing Field for Equipment Finance

Businesses choose to lease or finance equipment for a variety of reasons ranging from cash flow management to avoiding equipment obsolescence. The business model should drive the decision whether to lease, finance, or outright purchase, not the tax code.

Should you have any questions regarding these submissions please feel free to contact me, or ELFA's Vice President of Federal Government Relations, Andy Fishburn at 202-238-3419.

Sincerely,

William G. Sutton, CAE
President and Chief Executive Officer

Attachments (3):

Comprehensive Tax Reform Background and Key Points

Maintain Cost Recovery and Interest Deductions Background and Key Points

Tax Neutral Treatment Background and Key Points

Comprehensive Tax Reform

Background

Congress has spent the last several years debating the need for a comprehensive rewrite of both corporate and individual income tax laws. The growing concern of the rising federal deficit and the belief the code is unfair and uncompetitive are driving the debate to remake the laws to encourage economic growth, properly allocate capital, and create international competitiveness.

Both the House Ways and Means Committee and the Senate Finance Committee have held hearings addressing many aspects of tax reform. Over the past eighteen months, Chairman Dave Camp (R-MI) has introduced tax reform proposals that address international tax reform, small-business treatment, and financial products. The House has also created working groups on various aspects of a comprehensive tax proposal, an effort to bring ideas from both parties into a final product. Chairman Baucus (D-MT) has held individual meetings with Finance Committee Senators to build support for a comprehensive proposal. President Obama's Department of the Treasury released "The President's Framework For Business Tax Reform" in 2012. All of the proposals and meetings help push the dialogue to promote reform.

ELFA's Board of Directors passed a Policy Statement on Tax Reform at their October 2012 meeting. The statement calls on tax reform proposals to promote economic growth, competition, fairness and predictability. It also promotes specific values of the equipment leasing and finance industry such as: maintaining cost recovery and interest deductions; treating owner-lessors and owner-operators in a tax neutral manner; provide level playing fields for lessors and other financial providers; maintain the tax-exempt treatment of state and local government obligations; and promote a competitive international tax system.

Proposed changes that will reduce the corporate tax rate and broaden the base by reducing or eliminating tax incentives can have a major impact on leasing and financing transactions. As Congress further explores tax reform through hearings and studies, it is important that the industry be part of the debate and discussion.

For more information contact Andy Fishburn at afishburn@elfaonline.org or (202) 238-3419.

Comprehensive Tax Reform

Key Points

- Within the context of tax reform, the cost of capital must be a key consideration for policymakers as **capital formation incentives are critical to job creation and the growth and viability of the economy.**
- Tax policies must be enacted **that promote investment in productive assets and ensure the maximum flexibility** of financing options for asset acquisitions and business expansion.
- In that regard, **tax policies must be neutral in their application** so that tax rules **apply equally to owner-lessors and owner users.**
- **Appropriate leverage is a key component of capital formation** and equipment acquisition, construction, and development.
- Any changes to **reduce or eliminate interest deductions for tax purposes will directly increase the cost of capital** and harm economic growth, and accordingly, should be opposed.
- The tax code should continue to **provide appropriate incentives for investments** that will create economic growth and jobs.

Maintain Cost Recovery and Interest Deductions

Background

It is a long standing principle in the U.S. tax code that we tax income, and that income is broadly defined as revenues less expenses. In order to remain competitive in world markets, U.S. capital intensive industries must constantly replace and upgrade their plant and equipment because of wear and tear, as well as economic and technological obsolescence. Cost recovery and depreciation deductions reflect the cost of a taxpayer's investment in plant and equipment and allow tax deductions over time for these significant business expenses.

Capital intensive businesses also rely on debt to provide a significant portion of the funds necessary to acquire the plant and equipment necessary to conduct business. The interest paid on the debt is an ongoing cash expense of conducting business which has long been recognized as a proper federal income tax deduction. To deny a tax deduction for interest expense relating to the acquisition of plant and equipment will artificially inflate taxable income. This will result in a dramatic increase in the cost of, and reduce the overall level of, investments in capital equipment, thereby reducing the competitiveness of American business.

ELFA believes that it is very important to maintain cost recovery deductions for capital intensive businesses, and because the leasing industry provides lease financing for so much plant and equipment, equipment lessors must be entitled to the same depreciation and cost recovery as owner/users. Any changes to reduce or eliminate interest deductions for tax purposes, reduce or eliminate the ability to deduct lease payments as expenses, or that eliminate or make arbitrary changes to equipment depreciation schedules, would create a situation where business would be left with true capital related expenses that they would never be able to utilize to offset their revenue when determining their taxable income levels. This would greatly increase the cost of capital, would create an inflated income statement, and would have an adverse effect on economic growth and also would increase the effective tax rate.

For more information contact Andy Fishburn at afishburn@elfaonline.org or (202) 238-3419.

Maintain Cost Recovery and Interest Deductions

Key Points

- ELFA recognizes that the Committees of jurisdiction have done good work laying out the issues presented by debt financing vs. equity financing.
- It is critical to our membership that any resolution aimed at solving these larger issues not impact the basic ability of a business to deduct the cost of doing business from their revenues when calculating their income.
- Unintended consequences in this area could have a chilling effect on the \$725 billion dollars that the leasing and financing of capital equipment sector contributes to our nation's economy each year.
- ELFA supports tax reform proposals that maintain the ability of businesses to deduct business interest associated with the financing of equipment purchases.
- ELFA supports proposals that maintain the ability of businesses to count leasing expenses against revenue when they are calculating their income subject to tax.
- ELFA supports tax reform proposals that maintain the ability of businesses to depreciate capital assets over time.
- In addition, ELFA supports the continuation of the variety of provisions in the IRC that promote capital formation, such as maintaining section 179 expensing levels.

Tax Neutral Treatment

Background

Businesses choose to lease or finance equipment for a variety of reasons ranging from cash flow management to avoiding equipment obsolescence. The business model should drive the decision whether to lease, finance, or outright purchase, not the tax code.

Provide a Level Playing Field for Lessors and Other Finance Providers

Lenders and equipment lessors often provide competing sources for financing plant and equipment. When a lender provides a loan, it typically acquires the funds for the loan through a combination of borrowed money and equity. Thus, it incurs interest expense on the money it borrows and earns interest income on the money it lends. The interest income is balanced out against the interest expenses so the lender only pays taxes on the difference between the two, or the income actually made by lending.

For a lessor leasing the same item of plant or equipment in a “true” lease, it will earn rental income from its lessee rather than interest income. A lessor assumes the risk of the ownership of the asset and is not merely providing financing. Among the various tax reform proposals is one to deny deductions for “net” interest expenses. For a lender, the proposal would permit a tax deduction for its interest up to the amount of its interest income, disallowing only the “net” interest expense. For a lessor to be on the same footing with a lender financing the same item of plant or equipment, it should be allowed to “net” its rental income against its interest expense.

Treat Owner-Lessors and Owner-Operators in a Tax Neutral Manner

Purchasers who operate equipment (owner-operators) are allowed specific deductions or credits in the tax code as part of normal business operating practices. Those provisions include the right to depreciate the equipment over time on their tax returns and/or to deduct the interest paid on the loan. A lessor who purchases equipment to then lease to another business is the owner of that property (owner-lessor) and assumes the risk of ownership. The tax code currently recognizes that ownership regardless if the owner operates or leases the equipment. Reform efforts should continue to recognize the owner, whether an operator or lessor, to provide either type the same treatment in the tax code.

ELFA supports tax reform proposals that place a business that purchases equipment and then leases it on the same footing with an owner who personally operates that same item of plant or equipment.

For more information contact Andy Fishburn at afishburn@elfaonline.org or (202) 238-3419.

Tax Neutral Treatment of Financiers

Key Points

- ELFA members may lease or finance the purchase of capital equipment. In both instances, the tax treatment of the purchase should have equal standing in the tax code.
- Businesses choose to lease or finance equipment for a variety of reasons ranging from cash flow management to avoiding equipment obsolescence. The business model should drive the decision whether to lease, finance, or outright purchase, not the tax code.
- “Net” interest expense, whether from interest on a loan or from rental payments in a lease, should be treated the same under any tax reform proposals.
- ELFA supports tax reform proposals that place a business that purchases equipment and then leases it on the same footing with an owner who personally operates that same item of plant or equipment.