Ten Factors to Consider When Deciding Between Buying and Leasing a Business Vehicle - Part One

Many people understand the basics, but you need to walk through the specifics before pulling the trigger.

By Glenn S. Demby, Esq.

Key Takeaways:

- There are two ways to finance a new business vehicle: buying and leasing.
- Neither method is *inherently* smarter or better—for some of you leasing will make more sense, and for others buying will be the way to go.
- Make sure you weigh all the right factors to make the right decision for your business.

How many times have you wrestled with the buy-versus-lease decision? Each method offers advantages and disadvantages. The key to making the right choice for your own business is to recognize the factors involved and how to apply them to your own unique situation.

Ten lease-versus-buy factors to consider

Here are the 10 factors your need to consider when deciding whether to lease or buy a vehicle for your small business:

Factor 1: What you get for your money

Buy: Buying brings full ownership without restrictions on the vehicle's use and mileage.

Lease: When leasing, you pay only the portion of the vehicle's decline in value that's expected to accrue during the life of the lease—typically three to five years.

Weighing the options: The above is the conventional wisdom. Know that leasing *can* result in ownership and that you may be able to exercise the buyout at the end of the lease for less money than you'd have spent to buy the vehicle.

EXAMPLE

ABC Trucks "sells" identical pickup trucks retailing for $30,000 to different customers:

- Wanda Newford buys one of the trucks for $30,000.
- Lee Speier leases the other for four years with an option to purchase for $9,000 at lease end.

ABC believes the truck's fair market value will be $13,000 at the end of the lease. So ABC bases lease payments on $17,000 ($30,000 - $17,000). It turns out that the truck is actually worth $17,000 at lease end. Lee exercises the option.

Result:

- Wanda paid $30,000 to buy the truck.
- Lee paid $26,000 ($17,000 lease payments + $9,000 option) to acquire the vehicle.

Factor 2: What you pay up front

Buy: When buying a vehicle, you must come up with a chunk of up-front cash, including a down payment (or full cash price) plus:

- Sales and other taxes
- Other government or lender charges
- Optional insurance and services
- First monthly payment (if financing the vehicle)

Lease: You pay less cash up-front when you lease, including costs for:

- Capitalized cost reductions
- Taxes
- Other government or lessor charges
- Optional insurance and services
- First monthly payment
- Refundable security deposit

Weighing the options: Leasing is better if you have cash flow problems or better uses for your cash (e.g., the opportunity to use the cash for investments with a higher return). Of course, the cash trade-off isn't always black and white. Thus, you might benefit by simply making a larger down payment on the lease to get a lower monthly lease payment.

Factor 3: What you pay per month

Buy: Monthly payments are higher on purchases because you pay the entire purchase price of the vehicle plus sales taxes, interest, other finance charges, license fees, personal property and maybe other taxes.

Lease: Monthly lease payments are lower because you pay for only the depreciation of the vehicle over the lease term plus rent charges and taxes.

Weighing the options: Because lease payments are lower than monthly purchase payments, you can afford a more expensive vehicle by leasing it. In other words, the same $400 per month that gets you a Chevy if you purchase might be enough to lease a Cadillac.

Factor 4: What you pay in non-tax depreciation

Non-tax depreciation (i.e., erosion of the vehicle's fair market value during the time it's used) is a cost of both buying and leasing. Further, the non-tax depreciation makes its way into your taxes in the form of deductions and/or loss on sale (if you own the vehicle).

Buy: The decline in value from the time of purchase to the time of sale is a cost that adds to or subtracts from your pocketbook. But you might overlook non-tax depreciation and residual value when you buy a vehicle.

Lease: A lease is essentially a bet between you and the lessor on non-tax depreciation and its effect on the purchase price option at the end of the lease. In this "closed-end lease," you know up front how much you can buy the vehicle for at the end of the lease (as opposed to an "open-ended lease," where you don't know the actual residual value until you turn in the vehicle).

Weighing the options: Be sure you recognize that you're making a residual value bet either way. **When you lease**, you bet against the lessor. **When you buy**, you bet against yourself. You are taking the risk that the vehicle's value will depreciate more than expected, leaving you owing more on the loan than the vehicle is worth. Leases don't leave you "upside down," because the *lessor* assumes the risk of unexpected depreciation.

Factor 5: The tax deductions you get

Whether you buy or lease, you are generally allowed to deduct the business costs of the vehicle using either IRS standard mileage rate for the tax year or their actual expenses.

Caveat: Remember that you can't use the IRS standard mileage rates--you must rely on actual costs if your *corporation* owns or leases the vehicle.

Conclusion

The question of whether to lease or buy business vehicles has bedeviled small-business owners (and their advisors) for years. Neither method is inherently superior to the other. To make the smart decision, you need to consider your particular circumstances, including cash flow, taxes and psychological needs. Your financial advisor can often walk you through the pros and cons of each approach to help you make a confident decision without buyer's (or leaser's) remorse. In part 2 of this article, we'll look at what happens when you get rid of the vehicle, what you pay for excess mileage and wear, how much flexibility you need, and other personal considerations.

About the Author

Glenn S. Demby, Esq., *is an attorney and prize-winning B2B journalist who specializes in explaining complex regulationin plain English. He has received recognition for his unique ability to offer business professionals how-to solutions to their day-to-day compliance challenges. If you are interested in speaking to Glenn about a writing or consulting assignment, you can reach him at 203-354-4532 or at glennsdemby@gmail.com.*

This article was adapted with permission from MurrayBradfordTaxInstitute.com, a site dedicated to helping self-employed taxpayers and one-owner businesses save on taxes.

===================================== END PART 1 ============================