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SELECTED TOPIC

Bring Back the Investment Tax Credit

The accounting changes proposed by the Financial Accounting Standards Board (FASB) on August 17, 2010 will be under review until December 15, 2010. When the opinion period closes, a majority vote by the nations comprising the International Accounting Standards Board (IASB) will make the final decision on changes to the FASB rules regarding leasing. If passed, all leases will become transparent on a financial statement; leases will be treated as debt. However, since most leases are capitalized, there may not be a major change for both lessee and lessor, but there will be significant changes.

The purpose of the pending changes is to give full disclosure of debt to creditors and investors, as well as lessees and borrowers. True rents will remain, but they will be on a shorter time span and the equipment must have value at the end fulfilling certain definitions. The balance sheet will reflect the present value of the rent stream plus all expected fees and penalties as a right-to-receive lease payment and a lease liability. The leased asset will go into assets and be straight-lined over its useful life to the lessor, with no liability on the balance sheet if the lessor paid cash for it. If the lessor borrowed money to purchase the asset, it's a liability.

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The FASB changes will bring transparency as well as opportunity, and it could be very positive for the leasing industry in the long run. In addition, a lot of energy and attempts to influence or block the pending changes during the opinion period could've been saved with another approach—bringing back the investment tax credit (ITC) for equipment purchases as well as for hiring new employees. Because, as Terry Winders, CLP said in the August 30 *Leasing News,* "The real problem with changing minds comes from the international nature of the changes and the fact that most countries involved in leasing will now all be using the same accounting rules. That means that any changes in this proposal must have international backing and there does not seem to be any movement in that direction."

As an investor in a company or a creditor wanting to grant credit, don't you want to see all debt? It is one of the main things that got the mortgage industry in trouble. Lack of transparency led to greed and subsequent

credit approvals due to the nature of what the real debt was. The new changes may indeed benefit both small businesses and the entire business community, including banks, leasing companies and investors.

To get the economy going again, bringing back the ITC is an incentive for small businesses to get back into the game. It is of particular purpose as it applies solely to American products, not manufactured equipment from overseas. It was the alleged abuse of the ITC that originally brought its downfall, but now with all balance sheet debt being exposed, it should be a different story. Incentives are needed that produce growth with modern, innovative equipment to make U.S. industry more productive and competitive, while helping to introduce new software and equipment. It has always been ingenuity that built this country, not cheaper labor.

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If we can get small businesses buying again, most will finance or lease. Many may also try "operating leases," which the Equipment Leasing and Finance Foundation said only 9% did in 2009, mostly for large leases. Maybe it will be more operating leases for both the middle and small marketplaces—and more turnover of equipment and software, too.

ITC History

The ITC was enacted as the Revenue Act of 1962 by President John F. Kennedy, who advocated the credit to stimulate capital formation. He believed higher levels of capital formation would raise productivity, keep people employed and alleviate a serious balance in payment problems at the time. In the Act, Congress agreed "to encourage modernization and expansion of the nation's productive facilities and thereby improve the economic potential of the country, with resultant increase in job opportunities and betterment of our competitive position in the world economy."

In 1966, President Lyndon Johnson temporarily suspended the credit and accelerated depreciation on real property from October 10, 1966 to December 31, 1967 to combat inflation. It was again abolished from 1969-1971. In 1971, the Revenue Act reinstituted the credit to help ease high unemployment, inflation and little growth. The Tax Reduction Act of 1975 increased the ITC from 7% to 10% for qualified property acquired before January 1, 1977. Once again, Congress believed increasing the tax credit would create more jobs, increase productivity, reduce inflation and improve the U.S. balance of payments.

President Ronald Reagan enacted the Accelerated Cost Recovery System (ACRS) in 1981 to address debate about useful life and depreciation. More changes followed. The Tax Reform Act of 1986 abolished the ITC. Then came more "tweaking," and instead of the tax laws becoming more simplified, they became quite complex, and the removal of many items were not tax increases, but deductions eliminated. Everyone was fearful of raising taxes. In reality, it was raising taxes by eliminating deductions.

One of the most important ITC aspects is that it applied to American-made equipment. While bonus depreciation has its value, it does not promote American manufacturing or its products, including software. Over its lifetime, the credit ranged from 5% to 7% to 10% of the equipment or software cost off income tax.

By bringing back the ITC, Congress could encourage small businesses that want to acquire modern equipment, as well as new employees to help serve and produce. It will help create more real operating leases as well as more write-offs for businesses. It certainly would help the finance and leasing industry. ●

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