New Tax Law Could Spur Swap Meet for Used Business Equipment

THE WALL STREET JOURNAL February 24, 2018

Companies get big tax incentive to buy, sell used airplanes and other goods

Jamie Knorring, president of commercial shelving maker B-O-F Corp. in the Chicago area, is planning to buy a used factory machine to make clamps as part of a broader plan to boost worker productivity.

Making workers more efficient isn't the only factor that makes it a good purchase for him. Buying the equipment can also lower his tax bill.

The new tax law allows firms to claim an immediate 100% deduction when they buy an asset, including purchases of used equipment that have already been written off by previous owners.

"It sweetens the deal," Mr. Knorring said of the tax benefits of buying the equipment. The company, which has about 70 employees and took in revenue last year of approximately $20 million, is planning to buy other equipment including a welding robot, purchases made easier to justify given the new tax incentive, he said.

The new tax law allows firms to claim an immediate 100% deduction when they buy an asset, including purchases of used equipment such as airplanes that have already been written off by previous owners. PHOTO: LUCY NICHOLSON/REUTERS

Tax planners say the market for used equipment—including railcars, airplanes and industrial machines—is likely to heat up in the months ahead as firms try to take advantage of changes in the tax law. It could mean a shuffling of assets by companies purely for tax reasons and mergers and acquisitions that exploit new tax edges.

Before now, smaller companies could fully deduct purchases of used equipment, but larger firms had to spread those deductions over many years, and faster depreciation schedules applied only to new assets.

Under the new law, one company's gently worn asset could be worth more in another company's hands. That situation creates an incentive for deals that get tax deductions to companies that can use them and income to companies that already have lower tax rates.

Tax lawyers say they are flagging the possibilities to clients.

"We might well see the development of a kind of swap meet for slightly depreciated business assets," Chris Sanchirico, a tax law professor at the University of Pennsylvania.

Because the law is still new, the market hasn't yet caught fire.

Tax lawyers said one asset class that could get attention is airplanes.

Consider a case of a company that borrowed money to buy a $10 million airplane that is now worth $9 million. For tax purposes, depreciation deductions have already lowered its value to about $4 million. The tax law's new limits on business interest also limit the company's ability to deduct its interest costs.

The company might enter into a sale-leaseback deal that replaces the borrowing arrangement with a leasing deal that shares the tax benefits between both firms. A bank could buy the plane and take a full $9 million deduction on the aged plane right away. The company would owe taxes on its $5 million gain, but the new lease payments would be tax deductible for the airline, while the interest payments wouldn't have been.

"The assets now in the hands of the buyer are worth more than they were in the hands of the seller," said Eli Katz, a tax lawyer at Latham & Watkins LLP in New York.

The tax changes will likely accelerate purchases of new and used aircraft, said Michael Morgan, an investment banker at Burnham Sterling who advises airlines.

“It’s certainly going to be helpful on the margin and we’ll see more acquisition of aircraft because of this,” Mr. Morgan said.

Sale-leaseback deals and other transactions that take advantage of the new rules could also make sense in the rail and energy industries, tax lawyers said.

The Internal Revenue Service has sometimes looked askance at sale-leaseback transactions as tax shelters, depending on how they are structured, and has created an “obstacle course” of rules that businesses must traverse, Mr. Sanchirico said.

Randolph Smith, a national practice leader at Grant Thornton, LLP, said any transactions would likely have to meet a test for having a business reason other than tax avoidance.

“It seems like another of these things that will be industry-specific and it will be relatively easy in some cases based on the idiosyncratic character of certain industries and might be harder or impossible in others,” said Ari Glogower, a tax law professor at Ohio State University.

For now, the swapping and leasing markets are quiet as lawyers work through the possibilities.

“I haven’t seen a groundswell of sale-leasebacks of used assets but I think we are going to see that type of thing,” said David Burton, a tax lawyer at Mayer Brown LLP in New York who specializes in lease transactions. “It’s coming. It’s all coming.”