

Finance Leases and Operating Leases...

Finance leases are leases of assets for a fixed term where the lease payments relate to the value of the asset and not the use of them. Consequently, under a finance lease, the payments compensate the lessor for the full value of the asset and ownership of it passes to the lessee on termination. Lease payments under an operating lease instead compensate the lessor for use of the asset.

From a tax perspective, characterisation as an operating lease is often desirable for the lessee, in order to ensure the lease payments remain deductible in the year they are incurred. This begs the question whether the terms of a finance lease may be rewritten to achieve operating lease character. The answer is no. They are fundamentally different instruments. Under a finance lease, both the lessor and lessee intend for ownership of the asset to pass to the lessee on termination of the lease. The lessor expects to be paid for the value of the asset and the lessee expects to be financed into purchasing it. This is in fundamental conflict with an operating lease, hence I discount any prospect of merging the two ideas.