

# “Tax Exempt” Municipal Leases & Tax Exempt Bonds

## What is "tax-exempt" municipal leasing? *(A non-technical/non-legal definition)*

Or perhaps you've heard about municipal leasing's first "financial cousin," the tax-exempt municipal *bond*. Both are very low cost methods of financing the acquisition of essential equipment, vehicles, hardware and software for state, county and municipal governments. (There are however some very significant differences that we'll cover below)

But let's start with the "tax-exempt" piece first as it is sometimes misunderstood. First and foremost, the I.R.S. created tax-exempt municipal leasing (and bonds) as vehicles to provide state, county & municipal entities--state and political subdivisions, with access to the lowest cost of funds. The I.R.S. accomplished this by allowing banks and investors to deduct the interest earnings and carrying costs on these transactions from their federal income taxes--thereby lowering the funding source's "cost of doing business" and allowing them to make loans at considerably more aggressive rates than would otherwise be possible. Hence the "tax exempt" nomenclature that we use to distinguish this unique type of financing. It is the funding source that is "exempt" from their federal (and sometimes state and local) taxes. This I.R.S. tax exemption should not be confused with sales, use (or other) taxes which most, but not all governments are exempt from on their typical purchases.

## What is the difference between a municipal lease and a municipal bond?

Both are types of multi-year borrowings. Both reflect the very attractive interest rates characteristic of their tax-exempt pricing as described above. But there are some BIG DIFFERENCES to you, the borrower.

Bonds are based on an unconditional pledge of the "full faith and credit" of the municipal entity, including a pledge to levy property taxes on every tax-payer in the jurisdiction, as necessary to cover the bond debt. This is why most bonds require public consent in the form of complicated, time-consuming and expensive voter referendums.

In direct contrast to bonds, **municipal leases ARE subject to the annual appropriation of funds**--meaning that if funds are not available to make the payments for any legal reason, in any budget year, the government entity would have the legal prerogative to terminate the lease after the current budget period without legal penalty and to return the equipment/vehicles to us (the Lessor). This is one reason why a municipal lease, unlike a bond, does not create balance sheet debt for the Lessee (municipal entity).

While the very low interest rates on tax exempt municipal leases compare favorably with bonds, municipal lease issuance expenses are just a small fraction of the those involved in the documentation and legal compliance required for bonds--making bonds a much more expensive option for all but the largest (multi-million dollar and up) transactions.

Important Note: Always consult qualified tax and legal counsel on lease, bond and tax matters.



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