GARBETTS
Chartered Certified Accountants

HIRE PURCHASE, OR LEASE?

The decision to buy, hire purchase, or lease an asset will generally depend on the financing available to your business.

There are different treatments for tax and accounting purposes, depending on the type of finance contract entered into, and these will need to be considered together with the VAT treatment.

Outright purchase

This section covers outright purchase for cash or by bank loan, etc.

Accounting treatment

The asset is capitalised in the balance sheet and an annual charge for depreciation is deducted as an expense in the profit and loss account, which in turn reduces the value of the asset in the balance sheet.

The annual depreciation charge is calculated in accordance with accounting standards, based on the useful economic life of the asset and the residual value.

Tax treatment

Depreciation is not allowed for tax purposes, but capital allowances are available. Investments in plant and equipment (not usually cars) by small and medium-sized businesses attract a first year allowance of 50%. After the first year, relief is given by a writing down allowance of 25% on the tax written down value.

Some energy efficient assets have accelerated first year allowances, of up to 100%

The former 100% First Year Allowance for IT and telecom equipment has been abolished.

Where there is some private use of the asset, a proportion of the allowance is disallowed.

Where the asset is a car costing over £12,000, the annual allowance is restricted to a maximum of £3,000.

Assets with especially long or short lives are sometimes treated differently.

VAT

Unless the asset is a car, the VAT shown on the supplier's invoice will generally be recoverable by the purchaser, if he or she is registered. Buying at the beginning of a VAT period will entail a wait of three months or more to recover the tax.
VAT on cars is recoverable only in very rare circumstances.

Arnold House 2 New Road Brading Isle of Wight PO36 0DT Telephone 01983 400350 Facsimile 01983 404016 E-Mail: office@garbetts.com www.garbetts.com

Garbetts Limited Chartered Certified Accountants and Registered Auditor Registered in England Number 2988424 Director: Paul R Garbett FCCA
Part of Garbetts Group Limited Registered in England Number 2886513 Directors: Paul R Garbett FCCA, Robert Garbett, Sandra Garbett BA (Hons) Law

GARBETTS
Chartered Certified Accountants

Hire purchase and lease purchase

Hire Purchase and Lease Purchase (sometimes referred to as a finance lease) arrangements are generally treated as the purchase of an asset with a linked loan.

The tax and accounting treatment is therefore generally in line with those for an outright purchase. The finance charge in the accounts is normally allowed against tax.

Operating leases

An operating lease is where an asset is rented for a period, not necessarily fixed, and returned to the owner at the end of the period. Contract hire is a typical form of operating lease.

Accounting treatment

The asset is not capitalised; the rental payments are charged on an acceptable basis over the lease term to the profit and loss account.

Tax treatment

The accounting treatment is an acceptable treatment for tax purposes, where the accounting standard has been applied. No adjustments to profits, therefore, need be made.

Where an asset is a car with an acquisition cost of £12,000 or over, there is a restriction on the amount of rental payments allowed for tax purposes.

Capital allowances are not available.

VAT

Each rental or instalment will have VAT added so that the VAT cost is spread throughout the period of the agreement.

Where the asset is a car, only 50% of the VAT on the leasing charges can be reclaimed. If identified separately, the VAT on any maintenance element of the contract can be reclaimed in full (in the case of cars registered on or after 1 August 1995).

The disposal proceeds of leased cars registered on or after 1 August 1995 will be VAT inclusive.

Updated: March 2006

Arnold House 2 New Road Brading Isle of Wight PO36 0DT Telephone 01983 400350 Facsimile 01983 404016 E-Mail: office@garbetts.com www.garbetts.com

Garbetts Limited Chartered Certified Accountants and Registered Auditor Registered in England Number 2988424 Director: Paul R Garbett FCCA
Part of Garbetts Group Limited Registered in England Number 2886513 Directors: Paul R Garbett FCCA, Robert Garbett, Sandra Garbett BA (Hons) Law