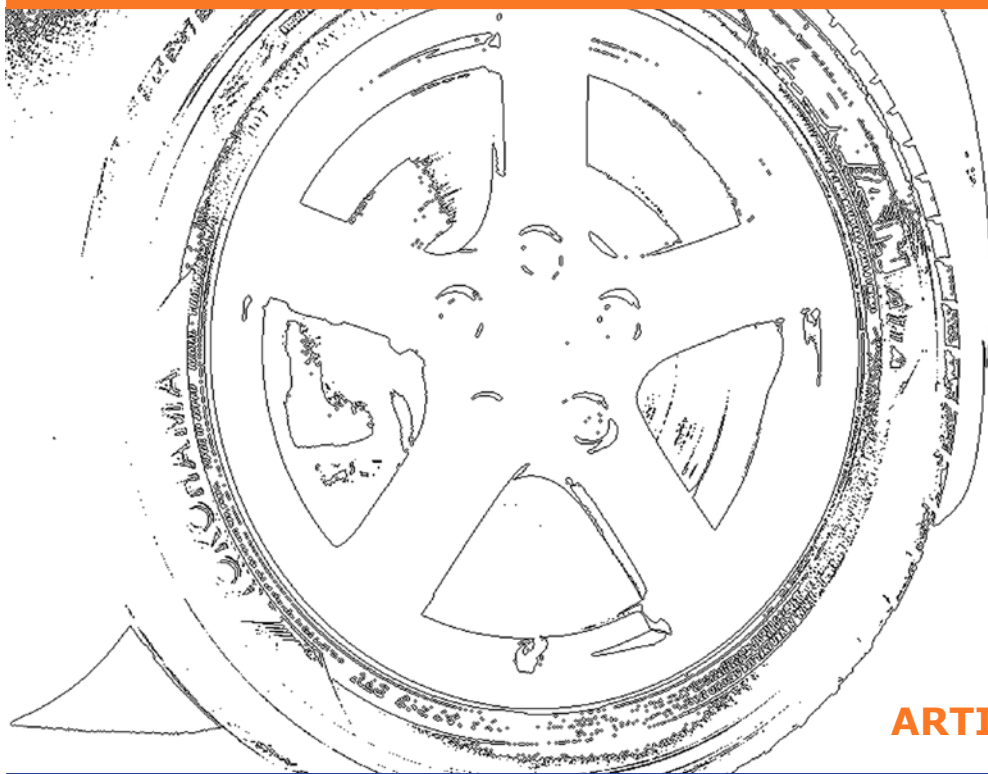


Knowledge

BANK



ARTICLE 13

A quick guide to hire purchase

A quick guide to hire purchase

Features of hire purchase

Hire purchase is defined in SSAP 21 as 'a contract for the hire of an asset that contains a provision giving the hirer an option to acquire legal title to the asset upon the fulfilment of certain conditions stated in the contract'.

Note the use of the word 'hire'. The contract is essentially a hire agreement. You only become the owner of the vehicle if you opt to acquire legal title (ownership) at the end of the agreement. It is not unusual to see hire purchase described as 'lease with option to purchase'.

However, for most people, hire purchase is simply a method of buying a vehicle on deferred payment terms and for this reason the word 'buyer' is normally used to describe the client, rather than 'hirer', and the payments are usually called 'instalments' or 'payments' rather than 'rentals'.

The agreement will give you the option to buy the vehicle for a nominal 'bargain' amount. You pay this to take title to the vehicle but need not do so if you do not wish to. If you prefer, you could simply pay the instalments and walk away. Unlike conditional sale, the option to buy is just that – an option – and not a contractual obligation. Normally, you will pay the option amount and take title.

Typically, the hire purchase payment profile will be one payment followed by 35 or 47 equal monthly instalments starting a month after commencement of the agreement. A deposit may also be required.

A hire purchase agreement is a financing agreement and you have all of the risks and rewards of ownership from the date of delivery, including residual value risk. Therefore, for accounting purposes the vehicle has to be shown as an asset on your balance sheet, and there will be a corresponding liability representing the balance due to the funder. This is the same accounting treatment that would apply if you financed a vehicle on a loan or a finance lease.

A quick guide to hire purchase

In nearly all hire purchase transactions you expect to become the owner. The tax regime recognises this and treats hire purchase not as a hire agreement, but as a deferred purchase agreement. Hence for corporation tax purposes the vehicle is deemed to belong to you from delivery. Therefore you can claim capital allowances as if you had paid for it in full on delivery. The lease rental tax disallowance rules do not apply to the hire purchase payments.

For VAT purposes the 'supply' is deemed to have happened at the time of delivery. The funder charges output tax on the sale and you account for input tax on the purchase. The instalments are not subject to VAT, unlike rental or leasing arrangements.

Vehicle hire purchase is widely available from contract hire companies, finance companies and banks.

It is suitable for the same group of borrowers as listed under contract purchase in 1.5 above.

Benefits of hire purchase

Hire purchase is a simple method of finance.

You can obtain capital allowances from the date of delivery. It does not suffer a partial lease rental tax disallowance.

Disadvantages of hire purchase

It is an on balance sheet form of finance and you retain the residual value risk.