



FACTSHEET 1

Asset Finance : Outright Purchase , HP Finance or Lease ?

Although there are many considerations ultimately your decision should be based on your current and expected cash flow reserves . Which of the above will best fit in with your working capital availability ?

Otherwise each of the above methods of asset finance brings tax relief and Vat relief in slightly different ways . Also each method affects the disclosure of assets and commitments in your annual financial accounts .

Outright Purchase

This would be financed by business cash, private capital introduced for this purpose or possibly by bank borrowing .

For accounts purposes the asset is capitalised in the balance sheet at full cost and depreciated against annual profits over its estimated useful economic life. Annual depreciation therefore systematically reduces the value of the asset in the balance sheet each year.

This annual depreciation charge is not an allowable deduction against profits for tax purposes. However, capital allowances can be claimed on the cost of the asset and these allowances are deducted from the company's trading profits for tax purposes. Year one capital allowances vary from 25 per cent to 100 per cent depending on the category of asset purchased. In subsequent years the asset attracts a continuing capital allowance of 25 per cent of its written down value. Only certain categories of building attract capital allowances of 4 per cent per annum. For the self employed any private use of an asset such as a car will require a percentage restriction of the capital allowances claimed.

With the exception of Vat on cars, the full input Vat on the suppliers invoice can be recovered by any Vat registered trader. From a timing perspective it is therefore better to delay any asset purchase until as close as possible to the end of any Vat quarter , enjoying the benefit of a much reduced Vat Return payment or indeed receiving a Vat repayment .

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HP Finance

Typically this reflects the acquisition of an asset over , say , a three year period usually requiring an initial deposit , an interest charge , an initial administration fee with an option to purchase fee payable at the end of the agreement . The finance company may require that a life cover insurance charge be put in place to run over the term of the agreement.

For accounts purposes the asset is treated as an outright purchase with depreciation calculated on the same basis. The commitment to pay future HP instalments is reflected as a liability in the business balance sheet. Interest is shown in each years annual trading accounts as an expense.

The tax treatment is no different from an outright purchase with the same capital allowance rules applying. The annual interest charge attracts full relief for tax purposes. Again private use of the related asset by a self employed person will require a restriction in both the capital allowances and interest relief claimed.

The Vat rules are no different from an outright purchase with the full amount of Vat being able to be recovered on the Vat Return covering the period of purchase.

Lease

There are now many forms of lease and it is difficult to comment on all of them without more detailed examination of the small print. For the purposes of distinguishing leases from the preceding two forms of asset finance it is worth looking at a straightforward and simple operating lease situation.

An operating lease is where an asset is leased for a period and returned to the owner at the end of the lease agreement.

For accounts purposes the related asset is not capitalised. The monthly or quarterly rental payments are simply shown as a business overhead reducing trading profits.

The tax treatment of the rental payments mirrors the accounting treatment with the payments being a tax allowable deduction from business profits. The allowable deduction for rental payments must be restricted where the related asset is a car costing over £12000.

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For Vat purposes the input vat on each rental payment can be reclaimed on the quarterly Vat Return. The leasing company will provide periodic Vat invoices. Where the asset is a car only fifty per cent of the vat on the leasing payments can be recovered. If the regular car lease rental includes an agreed maintenance payment then the full Vat pertaining to the maintenance part of the rental can also be reclaimed .

For further advice and before taking any action please give me a call.

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