

## Ask you CP Want the Latest word on leasing?

### The cost of convenience

Your Business needs a new computer system, updated machinery, or it's time to upgrade your vehicle. However, you don't want to dip into your capital reserves, so how do you acquire it?

By leasing. Leasing can offer you flexibility and convenience and, depending on your circumstances, substantial financial advantages over outright purchasing. Firstly, you conserve capital. In addition, you can enjoy tax deductions on lease rental payments.

However, the impact of the GST should also be taken into account. Broadly speaking, a business can claim a full tax credit for GST in most cases, except for items that are input-taxed, such as borrowing costs. In hire purchase arrangements, the timing of credit claims may be less favorable for cash basis purchasers for certain small businesses, than for those on accruals or invoice basis.

The basic test is: will the leased item produce a net increase in your cash flow, or a net gain in profit, over and above the tax deductions on rental costs?

If not, consider some other viable options.

### The alternatives

You can enter into a commercial hire purchase arrangement or negotiate a business loan with a bank or financial organization.

Each of these alternatives has different outcomes for a business, with tax benefits attached to each option. Assuming the item to be acquired will improve the cash flow or profitability of the business, the choice between leasing, commercial hire purchase and loans will depend on costs, interest rates and depreciation allowances.

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Depreciation is an important consideration because it can tip the scales one way or the other, given that the costs of the finance are similar. However, depreciation rates have not been reduced in recent years.

The differences between the three approaches are:

#### 1. Leasing

The business obtains a tax deduction for the lease rental payments, but the finance company or bank providing the lease finance retains ownership of the item and is able to claim depreciation. At the end of the lease period, the business has the first opportunity to buy the item at its residual value (its written down value after depreciation). If it does not, and the item fetches less than the residual value on the open market, the business is liable for the shortfall.

#### 2. Commercial Hire Purchase

The finance company retains ownership of the item until the business pays it off on a principal plus interest basis. The interest is tax deductible and, because it is the implied owner of the item, the business can claim a tax deduction for depreciation. In cases where the equipment has a high depreciation rate (e.g. heavy trucks and computers) the taxation benefits in the early years of a commercial hire purchase agreement may be greater than those achievable by leasing. Businesses can elect to have repayments scaled down in the early years of a commercial hire purchase contract and to make a 'catch-up', or 'balloon' payment, at the end of the contract.

#### 3. Loans

The interest payable on the loan is tax deductible and, because the business owns the item, the business can claim a tax deduction for depreciation. However, a bank or other financial institution may not provide loan finance unless the business puts up security.

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Each of the three outlined options needs to be analysed to determine not only the tax benefit through deductions and depreciation, but also the net costs. It is normally a condition of finance leases and commercial hire purchase agreements that the user, not the financier, pays registration, insurance and maintenance costs (as it would be if an item were bought with a loan). Stamp duty and statutory fees are also payable by the user.

### CPA standards

A CPA is best equipped to help make sound financing decisions.

CPAs are leaders in business, finance and accounting advice. The right to use the CPA designation is only given to degree-qualified professionals who have undertaken rigorous and comprehensive post-graduate study, the CPA Program.

In addition, CPAs are required to constantly enhance their knowledge and undergo ongoing professional development. This is achieved by undertaking structured professional development programs, including attendance at seminars, workshops, lectures and discussion groups.

CPAs are also bound by a strict Code of Professional Conduct and subject to regular quality assurance audits administered by CPA Australia.

With this combination of qualifications, skills and experience, CPAs remain at the leading edge of their profession, so you can be assured you will receive the best advice the next time you 'Ask your CPA'.

## Your financing checklist

- Will acquisition of the financed item really improve your net cash flow or net profit?
- Will your cash flow comfortably meet the costs of the financing package?
- Have you shopped around for competitive quotes on leasing, commercial hire purchase arrangements and loans?
- Have you analysed the tax and depreciation benefits of each option?
- Have you determined the total costs of each option?