



# Financing the cost of new business assets *to buy or not to buy...*

*...that is indeed the question. In fact, alongside 'did you ever consider doing something worthwhile for a living?' it is probably the question I'm most frequently asked.*



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Investment in new assets - be they plant and machinery, office equipment or company cars - is inevitable when running a business. Choosing the best way to finance the deal, however, can be more baffling than Lester Piggot's tax return.

The array of options divides into two basic categories - the first where the asset effectively belongs to you from the start; the second where you rent it for an agreed term. The two alternatives are treated quite differently for accounting and tax purposes.

## **Effective Ownership**

**Outright purchase.** Has quantitative easing left you feeling flush? If so, consider the advantages of an outright purchase of your new assets. With full ownership from day one and no interest costs to bear this is likely to be the most cost effective option. Financing the acquisition with an overdraft facility, on the other hand, is expensive and best avoided.

Full capital allowances for tax purposes are available in the year of purchase and could be as high as 100% of the cost, depending upon the circumstances.

**Hire purchase.** Sometimes known as 'lease purchase', you don't legally own the property until you have paid all the instalments due under the agreement. Just to cock a snook at the lawyers, however, we put the assets on your balance sheet and treat them as belonging to you from the outset. So there!


Financing assets in this way spreads the cost thereby helping cashflow, but you are charged interest for the privilege. The tax treatment is favourable, though, allowing you to claim full capital allowances on acquisition regardless of how many HP repayments you have actually made.

## **Rental**

**Operating Lease.** A simple rental agreement whereby the leasing company takes the asset back at the end of the term or you can choose to extend the period if it suits you. Either way, its eventual disposal is not your responsibility. As with hire purchase, your cashflow position benefits from paying by instalments.

For tax purposes, relief is given on the actual rental payments you make and is therefore spread throughout the period of the agreement rather than up front when acquired.

**Finance Lease.** Similar to an operating lease on the rental and tax relief fronts but you are treated as owning the asset for the purposes of maintenance and insurance. Accounting treatment follows the hire purchase model so that the asset magically appears on your balance sheet even though it doesn't legally belong to you. (Watch out for finance leases that extend beyond 5 years as you could be entitled to capital allowances - did I say that this was simple?).



**Contract Hire.** This is an operating lease with attitude. Often used for financing vehicles, the leasing company bears the cost of maintenance such as servicing and repairs. Naturally, this is factored into the rental cost but it provides peace of mind in knowing that unexpected repairs will not blow the budget.

## Further complications

**Balloon payments.** These can be built into the agreement to reduce monthly instalments. The balloon payment is a lump sum you pay at the end of the term financed from the residual value of the asset.

**VAT.** Renting an asset means paying VAT on the lease payments as you go along, whereas buying it - either outright or on HP terms - requires paying the VAT up front. Lengthy delays in reclaiming your VAT can be avoided by paying attention to the timing of your purchase.

**Cars.** Governments hate cars and devise all sorts of complex ways to tax us out of buying them. Accountants like cars because we can charge fees for interpreting the government's complicated rules. For example, you generally cannot reclaim VAT on the purchase of a business car but you can reclaim part of the

VAT charged on payments made to lease one. Go figure. Moreover, cars are subject to a comparatively less-than-generous but more-than-complicated capital allowances regime.

## Ticking the right boxes

There are three factors you need to consider when making your decision: cashflow, tax and commerciality.

For most businesses, spreading the cost will be essential. A balloon payment option can also help where cash is really tight, but remember that you are only buying time. Be realistic about how much the asset will be worth at the end of the deal. Also, shop around for quotes and don't be afraid to haggle over the terms - finance companies need you as much as you need them.

The availability of immediate tax allowances might not be as attractive as it sounds. Indeed, spreading or deferring the benefit could actually produce bigger dividends in the long run. Seek your accountant's advice on how best to optimise the tax considerations based on your own individual circumstances.

If you are operating in a fast-moving, high-tech environment, the flexibility offered by leasing could be the most convenient way to regularly upgrade your equipment.

In circumstances, where you might need the perceived stability of assets on your balance sheet, however, ownership might be preferred. Alternatively, by avoiding responsibility for equipment failures and breakdowns, leasing does reduce your exposure to risk. Some agreements can, on the other hand, be inflexible and difficult to terminate.

## Enough already!

Made up your mind yet? In case you still aren't sure, I can now reveal the simple answer to the lease/buy dilemma that you have all been waiting for:

### *It depends!*

Each decision needs to be made on its own merits taking into account the individual circumstances at any given point in time. There is no magic formula, but a full awareness of the available options should at least help the process.

By the way, if anyone does come up with a magic formula, please keep it to yourself. Otherwise I'll be out of a job.

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