

A Comparison of the Benefits of Hire Purchase (HP), Operating lease against Purchase of Assets

This table shows the differences:

<i>Alternative</i>	Finance lease or Hire Purchase	Operating lease / Hire	Outright purchase	Judgement
<i>Typical example</i>	Car/tractor: £20k – capital allowances	Photocopier maintained by supplier and returned at end of term.	Second Hand machinery	
<i>Initial Bookkeeping Debit/ Credit</i>	Dr Asset Dr Input VAT/ Cr HP Liability Cr Bank	None	Dr Asset Dr Input VAT/ Cr Bank	Purchase will add to your asset base
<i>Accrual of annual Interest</i>	Dr interest paid Cr HP liability	None	None	HP/Op leases can be costly
<i>Subsequent Bookkeeping Debit/ Credit</i>	Payments: Dr HP liability Cr bank Dr Depreciation Cr Asset NBV	Dr p&l lease charge Dr Input VAT/ Cr bank – usually a DD/ standing order	Dr Depreciation Cr Asset NBV	Finance Lease / purchase do not affect earnings calculations for business valuations
<i>VAT</i>	100% paid, re-covered upfront	Input tax re-covered as paid out.	100% paid, re-covered upfront	VAT recovered quicker with HP or purchase
<i>Corporation/ Income tax recovered on interest and ongoing costs</i>	Interest can be calculated on the rule of 78 – you then get early tax relief	Recovered as costs are paid out	None	
<i>Initial Capital Allowances</i>	Capital allowances from start.	No capital allowances.	Capital allowances from start	Conclusion: Try to buy outright if possible. Examine interest rates carefully if not. Compare to other forms of borrowing.
Evaluation	Spreads long term cashflow. HP can be at a dear rate. Interest needs to be recovered advantageously.	Can be good for a business that has low cashflow low profits or cannot recover VAT	Avoids paying interest. Best for profitable businesses with good cashflow.	

Notes

In loss making bodies its better to avoid an HP interest charge (which will not be tax relievable). It may be better to lease to reduce the cashflow cost. If you buy or use HP, do not claim redundant capital allowances.

You should generally try to buy outright, because HP interest tends to be more than other forms. But there are exceptions. The interest on HP may be cheaper than other forms (zero rate on some cars for example). Borrowing on HP may allow less finance to be needed in less profitable associates. HP interest can be front-loaded and therefore the tax relief can be better than for a loan of an equivalent interest rate.