

## FINANCE LEASE.

Finance Lease is a funding product designed to take advantage of a vehicle's future sale value. The monthly payments are effectively reduced from the outset of the agreement period. The agreement is a rental agreement under which other services such as maintenance are not normally provided or included.

The rental is calculated on the type of vehicle required by the client, what period of use and the likely mileage anticipated to be covered over the course of the contract period. This will help to determine the "balloon rental" which is based on the anticipated future value of the vehicle upon expiry of the contract period. The monthly rental that the client pays is therefore only interest and depreciation of the vehicle they have chosen to operate paid over the contract period.

Unlike contract hire and contract purchase the risk always remains with the client so should the vehicle make a profit or a loss on disposal the client will either pay the shortfall or enjoy the benefit of the profits.

The client remains responsible for the maintenance and running costs of the vehicle until the lease expires. The client has several options upon the expiry of the lease that should provide a suitable way to deal with the vehicle according to their particular circumstances at that time.

1. The vehicle is sold by the client to a third party to meet the "balloon" and a new lease is entered into with the client selecting a suitable vehicle to meet their new requirements.
2. The client may wish to enter into a secondary leasing period that can extend the use of the existing vehicle. The vehicle would be capitalised at the "balloon" amount and a new "balloon rental" set for the new period. This has to be agreed by the company with assessment being made on merit depending on the type of vehicle, its age, mileage and overall condition.

## VAT.

On August the 1<sup>st</sup> 1995 the treatment of VAT changed concerning vehicles subject to a finance lease that were registered from that day onwards. Because the company is buying the vehicles for 100% business use only (to finance lease to our clients) we are able to recover the VAT on the purchase price of the vehicle, this means lower interest charges for the client when calculating rentals. However, the client can, in turn, only recover 50% of the VAT charged on the monthly rental for finance leased vehicles.

It is possible to recover 100% of the VAT on the total finance lease rental if the client can prove categorically that the vehicle has been used only for business purposes. The company will be able to provide the best advice on the day to clarify such issues when they affect any clients VAT treatment relating to finance leased vehicles.

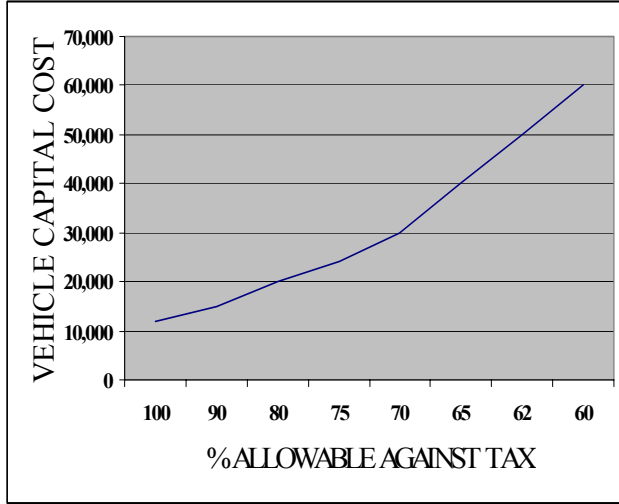
## TAX TREATMENT.

Under the current rules laid down by the Inland Revenue any vehicle that is operated under a finance lease agreement, costing in excess of £12,000, suffers a "tax disallowance" on rentals in line with the "half the excess" formula as illustrated below:

$$\frac{12,000 + \frac{1}{2}(\text{Capital Cost} - 12,000)}{\text{Capital Cost}} = \text{Percentage Allowable}$$

If the vehicles capital cost is £12,000 or less then the finance lease rentals (irrespective of whether they are including or excluding maintenance) are 100% allowable against tax. This applies whether the rental amount is £100 or £1,000 per month. This can be very advantageous as it has the effect of accelerating tax allowances to the benefit of the client. For example, if a vehicle were to be contracted under a finance lease at £450 per month then the amount allowable against tax would be £5,400 (12 x £450) as opposed to £3,000 capital allowance had the vehicle been acquired through cash or hire purchase. When this effect is multiplied across a number of vehicles or a large fleet the tax benefits can become extremely significant, reducing the client's tax bill substantially.

However, this formula has a reducing effect on the tax efficiency of a finance lease vehicle the more expensive the capital cost of the vehicle becomes. Therefore, there will be a point where the capital cost of the vehicle will render finance lease tax inefficient despite the effect of accelerated allowances that finance lease provides.



The graph above illustrates the percentage of the finance lease rental that would be allowable against tax in relation to the increased capital

cost of the vehicle. Because every client has different circumstances, priorities and requirements there is no hard and fast rules in establishing when, where and at what point finance lease becomes an unsuitable vehicle-funding product. Although tax is not the only issue Peter Holt Limited can advise a client as to what their position would be having taken the client's aims and objectives into account.

## SUMMARY OF BENEFITS.

- Any Vehicle make and model
- New or Used vehicles
- Streamlined Rentals
- Improved Cash Flow
- Protects Working Capital
- Potential Profits on Disposal
- Tax Efficient
- Accelerated Tax Allowances
- Improved Budgeting
- VAT Efficient