

# Financing Asset Purchases

## *Novated Lease, Operating Lease, Hire Purchase & Chattel Mortgage*

A number of financing options are available in the market place to obtain finance for the acquisition of capital assets such as motor vehicles, heavy machinery, plant and equipment. Each financing option has differing taxation and accounting treatments to be adhered to by the purchaser of the capital asset. This fact sheet provides basic taxation advice on the following financing options:

- Novated Lease;
- Operating Lease;
- Hire Purchase; and
- Chattel Mortgage

### **Novated Lease**

A novated lease is an agreement between an employer, an employee and a financier for the lease of a motor vehicle. The employer has the responsibility to make the lease payments each month out of the employee's gross salary and the employee has unrestricted use of the vehicle. Other running costs of the vehicle can also be deducted from the employee's gross salary. The employee agrees to salary sacrifice a part of their employment income an amount equal to the motor vehicle benefit. With a novated lease, the employee owns the vehicle and has the right to take the vehicle should they leave their job. The employee would then from the employment termination date take over making the lease payments to the financier.

### **Advantages for Employees**

The advantage for an employee to enter into a novated lease arrangement is that it is a tax saving because all lease payments are paid from gross (pre-tax) dollars and not net (post tax) dollars.

### **Advantages for Employers**

If the employer is registered for GST, the employer is entitled to claim input tax credits for the GST paid on the lease payments for the motor vehicle.

The employer can claim a tax deduction for all lease payments and the fringe benefit tax paid under a novated lease arrangement.

### **Fringe Benefit Tax**

When an employer provides a non cash benefit to an employee as part of their salary package, the benefit may be subject to Fringe Benefit Tax (FBT). FBT is a government imposed tax and is applicable to all vehicles under a novated lease unless the vehicle is an exempt commercial vehicle. An employer pays the amount of FBT payable regardless of their business structure. However, the amount of FBT payable is generally deducted from the employee's salary package.

Most of the employees that benefit from novated leases are those who have a salary in a higher tax bracket as deductions for the novated lease and related costs are taken out of their pre-tax salary. Given that FBT may be

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calculated on the value of the motor vehicle and also the distance traveled each year, those who frequently use their motor vehicle would also benefit the most from utilizing a novated lease.

### **Operating Lease**

An operating lease is an agreement between a consumer and a financial provider for the lease of an asset. The advantage of an operating lease is that it enables the consumer to lease an asset without the associated risks or the initial outlay for the cost of the asset. The legal ownership of the asset remains with the financial provider and you receive full use of the asset in return for monthly lease payments. At the end of the lease term, the consumer simply hands the asset back and their lease obligation ceases. Alternatively the consumer may pay a final larger installment at the end of the agreement to take over the legal ownership of the asset if desired by the consumer.

### **Goods & Services Tax**

If the consumer is registered for GST and the asset is used in operation of their business, the consumer is entitled to claim input tax credits for the GST paid on the lease payments for the asset.

### **Taxation**

If the asset is used in the business, the consumer can claim a tax deduction for all lease payments under an operating lease arrangement in the financial year taxation return in which the payments are made by the consumer. .

### **Hire Purchase**

Hire purchase agreements are a common form of financing the purchase of an asset, where the consumer pays installments and the legal title of the asset is retained by the vender until receipt of the final installment is made. The benefit of hire purchase contracts is that the purchaser has the right to use the asset throughout the period of the contract. Each installment contains a principal component and an interest component. The principal component relates to the payment of the asset and the interest component is to compensate the vendor for selling the asset via a hire purchase contract instead of a straight forward cash sale.

### **Goods & Services Tax**

If the asset purchased under a hire purchase arrangement is a taxable supply, the price you pay for the asset includes GST. If you use the asset in your business, you may be able to claim a GST credit back from the Tax Office for any GST included in the purchase price of the asset. The GST credit amount claimable back is one eleventh of the principal component (not the interest component) on each installment made in the period you paid it if you report GST on a cash basis. If your business reports GST on an accruals basis you are entitled to claim the entire GST in the period you purchased the asset.

Please note you are not entitled to claim the entire GST paid from the purchase of the asset if the asset is not used solely for business activities. The GST credit which can be claimed back from the Tax Office is calculated based on the business use percentage of the asset.

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## **Taxation**

The taxation treatment of an asset financed via a hire purchase is the same as if it were purchased straight up with cash or by financing through a bank loan. If the asset purchased is used in your business you are able to claim a tax deduction for depreciation of the asset along with the interest charged on the hire purchase finance agreement. General deductions can also be claimed for the operating costs of the asset such as repairs, maintenance, insurance and fuel.

## **Chattel Mortgage**

Under a chattel mortgage the finance company lends money to the consumer to purchase an asset. The consumer takes ownership of the asset at the time of purchase and makes regular repayments. However, the finance company also takes out a mortgage over the asset to provide security for the loan by registering a Fixed and Floating Charge with ASIC. Once the chattel mortgage is complete by way of final payment the finance company removes the charge giving the consumer a clear title of the asset.

## **Goods & Services Tax**

If the asset is used in the business and the consumer is registered for GST, then the consumer can claim the GST credit immediately in the business' next Activity Statement regardless as to whether the business reports GST on cash or an accruals basis. Unlike a hire purchase, no GST is claimed in each of the repayments over the life of the loan because the GST credit is claimed in the Activity Statement which relates to the period when the asset was purchased.

Please note you are not entitled to claim the entire GST paid from the purchase of the asset if the asset is not used solely for business activities. The GST credit which can be claimed back from the Tax Office is calculated based on the percentage of business use of the asset.

## **Taxation**

Tax deductions for an asset purchased via a chattel mortgage are the same as above for hire purchase contracts. As above, if the asset purchased is used in your business you may be able to claim a deduction for depreciation along with the interest charged on the hire purchase. General deductions can also be claimed for the operating costs of the asset such as repairs, maintenance, insurance and fuel.

## **Luxury Car Limit for cars**

There is a limit on the GST and depreciation deduction you can claim for a motor vehicle. Generally, if you purchase a car over the luxury car limit, the maximum amount of GST you can claim is one eleventh of the car limit. The car limit for 2008 – 2009 financial year is \$57,180 resulting in the maximum GST credit a business can claim back from the Tax Office for cars with a purchase price over \$57,180 during this financial year is \$5,198. This amount is reviewed each year and may be subject to change.

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There is also a limit on the depreciation tax deduction a business can claim for a motor vehicle. For the 2008 – 2009 financial year a motor vehicle can only commence being depreciated at an amount of \$57,180 and not at the higher purchase price if the motor vehicle's price exceeds \$57,180. The excess of the purchase price above \$57,180 will never be able to be depreciated by the business.

*If you have any questions or require any further information please feel free to contact your Client Manager and they will be happy to assist you.*

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