HETHERINGTON JOHNSTON

Vehicles

Lease or buy

If you are looking at buying a new vehicle and require finance, the salesperson will offer you two options: lease or purchase. This fact sheet gives an overview.

We also have an analysis sheet to help you crunch the numbers if you want to compare the costs and benefits of leasing and buying a vehicle for your business. The most important point to note is that over the normal period (usually 3 years) for lease or hire purchase:

The overall cost of owning or leasing a vehicle works out to be approximately the same over the three years when all cost factors are taken into account.

Leases and hire purchase (HP) or loans are simply two different methods of vehicle financing:

- Leases finance the use of a vehicle
- Hire Purchase finances the purchase of a vehicle

Each has its own benefits and drawbacks depending on the vehicle user's own circumstances.

What should you consider when comparing lease or buy options?

When making a decision to lease or buy a vehicle you must look at your personal priorities and your financial situation. Consider:

- Is having some ownership in your vehicle more important than low upfront costs and no deposit?
- Do you need the use of a new vehicle but lack the funds for a deposit upfront?
- Is it important to you to pay off your vehicle and be debt free for a while, even if it means higher monthly payments for the first few years?
- What will be your likely financial position at the end of the lease or loan period?
- These days there are no risks of major repairs because all new cars have extended warranties of 3 – 5 years and a minimum of 100,000 kilometres on the speedometer

Implications of leasing

There are two types of lease:

1. An operating lease

- An Operating Lease is a contract for the use of a new vehicle for a fixed period. It is usually 36 months (with a maximum term allowed for tax purposes of 45 months for a motor car) and the first payment is in advance. At the end of the lease period you hand the car back. Assuming the mileage is within the range set in the contract there will be no further payments required from the user.
- Operating leases can either be inclusive of full maintenance or not. The full maintenance option could mean significantly higher monthly lease payments

2. A finance lease

- A Finance Lease is also a contract for the use of a new vehicle for a fixed period. However a Finance Lease takes into account the likely value of the car at end of the lease period. This value at the end is called the 'residual value'.
- A Finance Lease with a residual value tends to have a lower monthly payment than either type of Operating Lease. Further the lessee can usually buy the vehicle for the residual value at the end of the lease period. If the user's vehicle use is greater than normal then there is a chance that the vehicle will be worth less than its residual value. If that is the case then there is an extra cost to the lessee.

When you lease, you pay an amount based on only a portion of a vehicle's cost, which is the part that you use for the duration of the lease. You have the option of not making any deposit and your monthly payments are fully claimable as an expense. You make your first payment at the time you sign the lease. If you are short of cash upfront, but do have good cashflow, a lease is a great way to acquire a new vehicle.

GST and leasing

With an Operating Lease, instalments are effectively rental payments. GST is charged on the full amount of the instalment and claimed as an input in the relevant GST return.

As Finance Leases usually have an option to purchase the vehicle at the end of the lease term, GST is charged only on the principal portion of each lease instalment and claimed as an input in the relevant GST return.

In both cases, if the vehicle is not used entirely for business purposes, the GST input tax claimed will be subject to the apportionment rules. Ask us to explain if you don't understand these.

Implications of buying

When you buy, you pay for the total cost of a vehicle regardless of how many kilometres you drive. You make a deposit, and pay an interest rate determined by the finance company or bank. You make the first payment a month after signing the contract and can select the period of time you wish the HP/Loan to be spread over.

Once the HP or loan balance has been repaid, you will own an asset. Given the nature of most vehicles the asset will be worth less than what you paid for it but it will still have a value. If at this point you want to upgrade to a newer vehicle you will have some equity that you can use as a deposit on a new vehicle. Alternatively you could continue to use the vehicle debt free. The age of the vehicle and whether you have maintained the vehicle while you have owned it may mean that your repair costs could be higher.

The vehicle may be used to secure any HP you take out to buy it. If you sell before the end of the HP term you have to repay the balance of the HP.

For tax purposes we treat the vehicle as a fixed asset and depreciate it at the appropriate rate. We also claim the interest on the HP or loan. The depreciation and interest claimed is often similar to what you would be paying if you were leasing the vehicle. Generally we find that the tax implications of leasing versus buying are minimal.

Our recommendation

If you are still unsure about how to proceed, please contact Hetherington Johnston at team@hj.co.nz or phone 04 566 3302 and we can run the numbers and talk it through. Our Vehicle — Buy vs Lease vs HP Asset Analysis tool allows us to compare the various options of leasing versus buying.

As stated at the beginning, the overall cost of 'using' a vehicle compared to the cost of 'owning' a vehicle is much the same over a period of, for instance, 3 years. It's important to decide which option works best for you and your business.