Leasing Guide

Leasing - the way forward

If your business needs commercial vehicles or plant and machinery, what's the best way to finance them?

Traditionally, many organisations have used loans or hire purchase (HP). However, there is a growing awareness that these may not always be the best options.

Leasing is a highly flexible way of acquiring the assets your business needs. It allows you to preserve working capital by financing equipment over the course of its cash-generating life.

Leasing can involve lower deposits and lower monthly payments than loans or hire purchase. It also gives you a new line of credit, totally separate from everyday business banking and overdraft facilities.

For certain assets, including technology, you can benefit from a full life cycle management service, including sourcing, maintenance and disposal.

How does it work?

Like loans or HP, you make regular payments over an agreed term. The monthly rentals and lease period can be tailored to suit the needs of your business.

With leasing, you do not own the assets – they remain the property of the leasing company. However, you will enjoy most of the benefits of ownership – including the right to sell the equipment at the end of the lease and retain the majority of the proceeds.

Leasing – the key benefits:

- Working capital preserved – payments spread over the life of the asset
- Allows equipment and plant to be updated as old assets need replacing
- Fixed monthly costs for greater control of cash flow
- Rentals can be offset against your taxable profits
- Flexible end of lease options

Simple and effective

Leasing can offer significant tax efficiencies for your business – without the need for complicated paperwork.

With leasing, the leasing company will claim the capital allowances. These are then passed on to you in the form of lower rental payments. This can be a real benefit to your business, especially if:

- You are unable to make full use of capital allowances, for example due to low profits
- You prefer to get the cashflow benefit immediately, instead of having to claim capital allowances later.

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Helping your cashflow

When your business buys assets through cash purchase or HP, you pay VAT and claim it back each quarter. With leasing, your rental agreement is based on the net value of the asset. This means you enjoy an immediate cashflow benefit, as you will not need to pay VAT upfront. During the lease period, the leasing company will charge VAT on your rental payments.

If you decide to sell the asset at the end of the lease, you will need to account to HM Revenue and Customs for VAT, based on the sale value.

Giving you the choice

At the end of your lease, you will have two main options:

- Sell the asset. Notify the leasing company, prior to the sale.
- Keep it or upgrade/replace it by extending your lease.

What if leasing is not right for you?

Leasing can bring many advantages and will suit some businesses better than others. You should consider leasing if your business:

- Cannot claim the full benefit of capital allowances
- Intends to use assets for less than their full working life
- Wants the immediate cashflow benefits of lower monthly payments
- Is unable to claim back VAT in full on purchases.

Of course, paying cash can still be an effective option. However, it may use up money that could be better invested in other areas of your business. You will also own an asset that is only likely to depreciate over time.

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Your Questions Answered

Will the asset appear on my balance sheet?

Yes. However, some types of asset finance, such as operating leasing, provide ‘off-balance sheet’ finance. This can increase your borrowing capacity and make the business more financially attractive to lenders and investors.

Who claims the capital allowances?

The leasing company will claim the capital allowances, and pass these on to you as reductions in the rental payments. You can claim the rentals as a business expense.

What if I want to upgrade or settle early?

Leasing offers you great flexibility. If you know that you will want to replace an asset before the end of its economic life, we can factor this into the rental agreement – for example, by agreeing a residual value or ‘balloon’ payment, which can help keep your monthly payments down.

Can I keep the asset at the end of the lease period – or sell it?

Yes. Normally, you can retain the majority of the sale proceeds. See ‘End of lease options’ for more details.

What interest rate will I be charged?

You do not pay interest on a leasing agreement; instead, you pay a monthly rental. Often, this will be lower than the capital and interest repayment on a loan. Another advantage is that with leasing, your costs are fixed – you know exactly what you will pay, regardless of what happens to interest rates.

Will I be ‘locked in’ once the lease starts?

No – you can cancel the leasing agreement at any time. Our terms are straightforward and transparent. If you want to upgrade or extend payments over a longer period, we will simply stop your original lease and then agree another.

Why are leasing terms and conditions so complicated?

Leasing is different from loans or HP and the documentation needs to establish that ownership of the asset lies with the leasing company, who ensure the agreements are clear, fair and easy to understand. We will happily explain them to you and your advisers if you have any questions.

Are there penalties for excessive use?

No. With a leasing agreement, we recoup our capital outlay over the term of the lease. We do not expect to get the asset back for resale.

The exception is operating leasing, where rental payments will be based on the expected resale value of the asset when it is returned to us.

Note – This guide is indicative only and may not reflect your exact requirements, please contact EDS for further information.