

# LEASING vs BUYING



## SO WHICH IS THE BETTER OPTION?

When it comes to leasing vehicles for business use, many of our clients are often not sure whether they have entered into a finance lease or operating lease for their vehicle. Both types of lease have significantly different consequences.

## THEN THERE IS THE QUESTION ... DO I LEASE? OR DO I PAY CASH?

Our experience is that almost everybody has a different or unique set of circumstances as to which may be the preferred or best option for them. It certainly isn't a one approach fits all.

Paying cash will, in most circumstances, be the best and cheapest option if you have the cash. We say this because at best the cash you are sitting on will only likely be getting the bank rate of return, whereas the cost of the lease will have built into it a finance rate, which is likely to be at a much higher rate than your own borrowing cost. It has to be doesn't it? Otherwise the lease company would not be in business.

The wording around lease agreements does vary, but generally speaking, they fall into one of two categories:

### FINANCIAL LEASE

A financial lease is one where typically the ownership of the vehicle will pass to the lessee at the end of the lease term, or where they have the option of purchasing the vehicle for less than a market rate. For tax purposes this type of lease is treated in the same way as a hire purchase/loan agreement. The vehicle is treated as an asset, the money owing to the finance company is recorded as a liability and depreciation is claimed on the vehicle. Basically a finance lease can be thought of as a modified version of simply taking out a loan to buy a vehicle.

### OPERATING LEASE

An operating lease is treated quite differently. The vehicle owner pays a monthly fee (which is tax deductible) and gives the car back at the end of the lease term. Both the vehicle and the lease commitment stay off the balance sheet. Keeping this debt off the balance sheet has the benefit of presenting a stronger financial position to potential financiers and investors.

There are a couple of hooks relating to operating leases that you should be aware of. Firstly leases can get expensive if you go over the mileage allowance that you agree on at the start of the lease period. Therefore make sure that you set an allowance that is sufficient enough to cover the intended use of the vehicle. The lower the mileage allowance, the cheaper the lease fee – so you always want to be certain that you don't end up paying for miles that you are never going to use. Secondly, you could end up with hefty charges at the end of a lease term if the vehicle is not returned in reasonable condition.

Regardless of the circumstances, the tax consequences of a lease agreement should be checked by a professional before signing.

We think one of the best examples of understanding the lease option versus outright cash purchase or finance deal is the following example:

Taylor Made Investments manufactures hideaway safes and employs two Sales Representatives who are regularly on the road. Both of them drive a \$45,000 Ford. Now that's \$90,000 in total. We've advised Taylor Made Investments that they are better to lease their vehicles than own these.



## WHY?

Because \$90,000 tied up in the cost of motor vehicles that depreciate in value every year would come at an economic cost to the company. Would it not be more effective if the company were able to have that \$90,000 tied up in stock? With a 100% mark-up on the company's product that's more sales, more GP and more profit, pretty much a no brainer really.

This of course assumes that Taylor Made Investments did not have \$90,000 cash in the bank that was not needed for anything else.

## BORROWING

Borrowing, even for a modest set of wheels, or leasing the vehicle shouldn't be done without some forethought. Just walking into a dealer and signing up for a car loan on offer isn't shrewd.

Car dealership finance might be easy, but it's generally a very expensive way to borrow. The lenders behind dealership finance sometimes concentrate on the more unreliable people and charge high interest rates.

If you think you're a reasonable credit risk then you should approach a lender instead of relying on the car dealership finance.

It's almost always cheaper to go for a car or personal loan through a bank.

Currently a banks secured personal loan rate is approximately 14.95% per annum , and its unsecured personal loan rate is approximately 17.95%.

It's worth remembering when borrowing from a bank or any other organisation that you're a good customer, not a bad one. Banks need borrowers. Therefore it is possible to haggle with the bank or lender for lower interest rates or better terms and conditions.

That's especially the case with people who have revolving credit mortgages, although the interest rate is lower on mortgage finance than car loans, the term is longer and the interest soon adds up.

Using a very simple calculation, a \$15,000 loan at 14.95% over five years would cost a total of \$21,387. If you whack that \$15,000 on the mortgage at 6.95% over 25 years, you would actually pay \$31,661.67. No one keeps a car for 25 years of course, but this illustration shows how spreading the cost over the life of a mortgage doesn't make financial sense.

The best way to extend the mortgage to pay for a car is to make the repayment term over five years for the portion of the mortgage covering the car. That way, you will save money. Depending on the purchase price of your vehicle, our preference would be that you only spread the loan term over 3 years.

If you would like to discuss further details then please contact our office.



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