Asset Finance: Guide for Advisers and Businesses

Introduction

With many businesses now focusing on investment and growth, the challenge is to find a suitable and affordable finance option for the type of investment they're planning.

In 2015, the FLA reported that almost 32% of UK investment in machinery, equipment and purchased software was funded using **asset finance – primarily leasing and hire purchase**.

Suitable for obtaining anything from telephone systems to factory machinery, these finance options are ideal solutions in cases where much-needed equipment may otherwise be out of reach due to limited cash flow.

This guide sets out the benefits of asset finance to help business-owners decide if it could help their businesses grow.

For further information or advice, the ICAEW Business Advice Service (BAS) will be able to direct interested business-owners to local accountancy firms which offer free sessions to explain how leasing and hire purchase works, including the tax treatment for assets funded in this way.

We hope you find this guide interesting and useful.

"With the highest application success rate of all the main finance sources, asset finance is particularly popular with small firms. In December 2015, lenders in this market reported 27 consecutive months of new business growth, showing that more firms are choosing either leasing or hire purchase to help them invest in essential equipment and machinery."

Stephen Sklaroff, Director General of the Finance & Leasing Association (FLA).

"The Government's decision to set the Annual Investment Allowance at £200,000 for the foreseeable future offers firms the certainty to plan their investment strategies, and asset finance should be part of the mix."

Michael Izza, CEO of the ICAEW.

"In collaboration with the Finance & Leasing Association, the British Business Bank has developed programmes and solutions for the asset finance industry to help meet increasing demand from smaller businesses to invest in and finance machinery and equipment."

Keith Morgan, CEO of the British Business Bank.

Why use asset finance (leasing and hire purchase)

Updating equipment or plant and machinery can be very expensive, and often the more urgent the case, the more challenging the cash flow position.

Asset finance (leasing and hire purchase), gives businesses access to the latest machinery, vehicles or technology which might otherwise be out of reach.

Perhaps you need a piece of equipment to fulfil an order, or you operate in an industry where hardware becomes obsolete very quickly, or you simply need to continue production while an existing machine is repaired.

In these scenarios, where you don't want to buy the item, **leasing** is a great option.

The usual arrangement is that a leasing company called the "lessor" would buy and own the equipment on your behalf, and you as the "lessee" would then effectively rent its use over a predetermined period. The lease agreement is usually at a fixed interest rate, which is a real bonus when budgeting or planning future expenditure.

Also, since the agreements are secured wholly or partially on the equipment being financed, the need for additional collateral is much reduced.

Alternatively, if you want to buy and own your next piece of equipment, but once again avoid the cash flow impact of an outright purchase, then **hire purchase** is a good option.

As before, a finance company would purchase the equipment on your behalf, and you as the "hirer" would repay the cash price plus interest through regular payments. These agreements are also usually at a fixed rate, so help with budgeting. At the end of the agreement, there is usually a nominal fee required for you to gain ownership of the equipment.

Most firms providing asset finance in the UK are members of the Finance & Leasing Association (FLA), and all their agreements are subject to the stringent standards set out in the FLA's Business Code of Conduct.

Leasing and hire purchase are available directly from specialist providers, or indirectly through the equipment suppliers or asset finance brokers (further details can be found on the final page).

Tax treatment of leases and hire purchase

Hire purchase (HP) – because an HP agreement covers most, if not all, of the useful life of the asset being financed, the accounting and taxation treatment classifies the business as the owner of the asset, even if a small payment is required at the end of the term of the agreement to gain title to the asset.

The total cost of the asset will therefore be shown on the balance sheet, with the payment shown as a liability. As payments are made, the liability reduces and the interest element of each payment is charged against profits as an expense.

So, if a business buys an asset on HP, they can claim the capital allowances – therefore offsetting the expenditure against taxable profits. The business will reflect in its profits the annual depreciation of the asset.

Leasing – when leasing an asset, the leasing company (the lessor or owner) buys the asset and rents it to the hirer or lessee for an agreed period. The accounting and tax treatment depends upon whether the lease is a finance lease or an operating lease.

Finance lease agreements usually run for all, or a substantial proportion, of the asset's working life. Consequently, the lessor transfers all of the risks and rewards of ownership of the asset to the lessee, which is similar to the position they would be in if they had bought the asset. The accounting treatment of a finance lease therefore follows a hire purchase agreement in that the asset is put on the lessee's balance sheet. Tax-ownership of the asset however remains with the lessor in substantially all agreements with a term of less than seven years. The lessor therefore claims the capital allowances and the lessee obtains a deduction from profits for the rentals paid.

Operating lease agreements have a much shorter duration, and therefore do not cover all or nearly all of the asset's working life. Consequently, it is the lessor (leasing company) which retains the risks and rewards of ownership, and the asset would not be shown on the lessee's balance sheet. The taxation treatment is the same as for a finance lease in that the lessor charges the lessee a rental for use of the asset, and this is deducted from the lessee's profits.

It is important that businesses understand what types of asset finance agreements are on offer and what the tax implications and associated benefits of each are.

IFRS 16, the International Accounting Standards Board's (IASB) new leasing standard will not come into effect until January 2019.


Only use the asset for as long as you need/require
Frees up capital
Gives you flexibility with your cash flow
Asset finance
'a market solution to a market failure in the small business lending markets.'
British Business Bank
Security taken only in the asset
Update obsolete equipment easily
Agreements tailored to your needs


Case study 1
Holme Farmed Venison

Holme Farmed Venison decided to introduce a new door-to-door service so customers can enjoy products at home.

The success of this initiative required the purchase of new land and equipment to meet growing demand. Financing this investment was difficult, however, due to the seasonal nature of farming and an irregular income stream.

Shire Leasing's seasonal payment structure meant that Holme Farmed Venison had the flexibility to increase repayments around the higher income months and make lower payments during the quieter ones.

Shire also offered a part payment plan for suppliers so the cost of equipment could be split and the business didn't suffer from any large upfront costs.

"We have fixed and variable plans that have allowed us to plan repayments when the company expects its better months. Cash flow planning in any business is essential and I was very pleased with the way they worked with us to achieve this. They also did not pay for things until we were satisfied the new equipment was fully operational, which allowed us to keep pressure on the suppliers to achieve."

Nigel Sampson
Director, Holme Farmed Venison

Case study 2
Dunwood Travel

When a tour operator based in Dudley wanted to purchase two new state-of-the-art coaches, and create three new jobs, they spoke to Lloyds Bank about a £345,000 funding facility.

After experiencing increased demand for its extensive choice of holidays for the over 50s, the business decided to activate its expansion plans and purchase its own 53-seater coaches, and move away from subcontracting its drivers and coaches.

Lloyds Bank's Commercial Finance team provided the hire purchase facility to buy the coaches. The facility allowed the company to purchase the vehicles and pay down the full amount over an agreed period to ensure its cash flow remains fluid.

"As the variety of holidays that we offer our customers has grown so has the demand for our services, and it was soon clear that we needed to expand to meet this uplift.

We previously hired vehicles for our excursions, but thanks to the invaluable support of the Lloyds Bank team we now have two new state-of-the art coaches in our fleet, marking an exciting stage for the business as we celebrate our twentieth anniversary."

Phil Westwood,
Director Dunwood Travel

Case study 3
Key Recycling

Key Recycling was established in 2009 and was developed to provide specialist composting equipment to support local on-farm composting sites.

When the Government's Renewable Heat Incentive (RHI) scheme was launched, the firm saw a gap in the market for woodchip fuel in its region.

Having worked with JCB Finance since the inception of the business, Key Recycling explained their plans and secured a £500,000 HP Fixed Plus facility. This funding arrangement enabled them to put down a low initial capital outlay, pay off lump sums without penalty and have the security of owning the equipment at the end of the financial agreement.

"As a new start business I appreciated that JCB Finance took the time to look at my business and what I was trying to achieve. Although I could afford to purchase the machine outright, placing it on finance freed up cash flow so I could take on new employees. All of my machines have been financed with JCB Finance, the investment and flexibility allows me to keep up with new technologies and buy more efficient equipment."

Dale Aston
Director, Key Recycling Ltd

Sources of information and finance

F L A

The Finance & Leasing Association is the leading trade body for the asset, consumer and motor finance sectors in the UK, and the largest organisation of its kind in Europe. Our members include banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms.

fla.org.uk

BRITISH BUSINESS BANK

The British Business Bank is a government-owned business development bank which aims to ensure that finance markets work effectively for smaller businesses, enabling them to grow, prosper and build UK economic activity. Using research, expertise and government money, the British Business Bank designs and delivers programmes that benefit start-ups, high growth, or simply viable but underfunded smaller businesses.

british-business-bank.co.uk

The Business Finance Guide
british-business-bank.co.uk/bfg

Looking for finance?

The Finance & Leasing Association

fla.org.uk/index.php/looking-for-finance

Business is Great

greatbusiness.gov.uk

NACFB helping fund UK business

smallbusinessfinancedirectory.co.uk

ICAEW is a world leading professional membership organisation that promotes, develops and supports over over 145,000 members in more than 160 countries.

As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

Because of us, people can do business with confidence.

ICAEW is a founder member of Chartered Accountants Worldwide and the Global Accounting Alliance.

charteredaccountantsworldwide.com

globalaccountingalliance.com

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