THE TAX BENEFITS OF LEASING EXPLAINED

Leasing enables the cost of capital expenditure to be spread and paid in manageable monthly rental payments. Hence a business has the "income generating equipment" it needs immediately and it can keep its cash reserves available for other needs.

Rather than investing cash in depreciating assets, the company can use them to help increase its profits

Tax relief may be available when acquiring business assets. The types of relief available depends on whether you buy them outright, or on the type and length of the lease. The way in which you fund the acquisition also affects whether VAT will be charged upfront or spread over the length of the funding agreement.

Leasing has potential favourable tax treatment over a purchase. In a true lease, you can in most cases deduct the entire amount of the monthly payment as an operating expense; in a purchase, the equipment is depreciated. Not only can the tax treatment under a true lease allow for greater tax savings, but the accounting work is made easier.

Moreover, certain types of lease financing qualify for accelerated depreciation expense under Section 179 of the IRS code. This allows a business to "front load" the tax savings and realise them in the year the equipment is acquired.

In most cases the cost of renting or leasing an asset is deductible as a business expense so this can reduce your overall tax bill

This could mean a saving of between 19% - 40% of the lease payments, depending on the rate of tax applicable to your business.

HOW THE TAX ADVANTAGES OF LEASING WORKS – IN NUMBERS*

You lease a machine that costs £5,000 + vat over a 3-year term.

The monthly payments would be £176.75 + vat or £40.79 + vat per week

The total amount paid over the term of the Lease would be £6,363 + vat

Tax may be reclaimed at a rate of 19% over the term of 3 years, equal to £1208.97

Therefore, the net cost of the lease is £6,363 - £1,208.97 = £5,154.03*

* This example is for illustration purposes only. The figures which apply to you may vary depending on your own tax position and financial status.

Capital allowances

When you buy plant and machinery and IT equipment, you can deduct a proportion of the cost from your taxable profits each year - known as capital allowances.

You can claim capital allowances if the equipment is:

- bought outright
- bought through hire purchase
- supplied under a long funding lease – over seven years (sometimes five years)

You can't claim capital allowances with shorter leases or if you don't have sufficient taxable profits. However the leasing company can, so you should benefit indirectly through lower rental charges.

REMEMBER

There are several advantages of leasing or renting equipment:

1. you don't have to pay the full cost of the asset up front, so you don't use up your cash or have to borrow money
2. you have access to a higher standard of equipment, which might be too expensive for you to buy outright
3. you pay for the asset over the fixed period of time that you use it, which helps you budget for the future
4. you can spread the cost over a longer period of time and match payments to your income
5. all lease payments are an allowable business expense, and therefore attract tax relief. Your accountant will be able to advise you further
6. if you have not bought the asset outright, you won't have to worry about any overdraft or other loan taken out to finance the purchase being withdrawn at short notice, forcing early repayment
7. the leasing company can usually get better deals on price than a small business can.
8. if you need to upgrade or replace the equipment, this can normally be handled by amending the existing agreement - which is a quick and simple process

The information in this publication is generic in nature. Whilst it is likely to be correct for most trading businesses, the benefits of leasing will vary depending on your own tax, financial and accounting position. We recommend that you consult your own accountant or other professional adviser to check how these will apply to you.

Tax rules are subject to change and the information in this document is correct at the time of its production.

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Kennet Equipment Leasing Limited. Kennet House, Temple Court, Temple Way, Coleshill, Birmingham B46 1HH. T: 01675 469200 F: 01675 469210