Financing equipment in the *tough times*

Keeping an up to date fleet of machinery can be difficult but there are ways and means

In these tough and uncertain economic times when businesses are making long-term purchasing decisions, they are not only looking for tailor-made financing options and the lowest possible interest rates.

More than ever they are reminded how important it is to only put their trust in a financing partner they can rely on to support them in the long-term – someone who understands their business and speaks their language.

"As a manufacturer owned finance company we are primarily here to help customers purchase our products, rather than simply to sell them finance.

"And this is actually more important in the bad times than in the good times," said Andreas Peppel, John Deere Credit's European Sales and Marketing Director.

"In recent years we have found an increasing number of golf clubs worried about the rising cost of maintaining and servicing older machines are taking up replacement finance schemes," added UK General Sales Manager Cameron Renwick.

"Instead of buying one or two items of equipment each year for cash, a financed package deal can enhance the entire course maintenance fleet by spreading the cost over a fixed period – and another benefit is there will be an immediate improvement in the quality of finish on the golf course, something members notice straight away."

Payments can be made using the normal range of credit options if required, or on a tailor made repayment schedule to match individual budgets and cash flows (see right).

ABOVE: New Malton Golf Club, near Royston in Hertfordshire, with its recently bought fleet of new equipment.

The normal range of finance options includes:

Hire purchase

You pay the VAT due on the equipment at the outset and make regular fixed repayments over an agreed period. Once all repayments have been made, you become the owner of the equipment.

For tax* purposes you are treated as the owner from the outset of the finance agreement and can therefore claim any capital allowances available.

Key benefits of hire purchase:

• Certainty that the finance agreement cannot be withdrawn as long as you continue to abide by the terms and conditions of the contract. This contrasts with bank overdrafts, which are repayable upon demand.

• The regular nature of repayments and a fixed interest rate make budgeting easier.

• A cost-effective way to fund acquisitions. Using a traditional bank overdraft to fund equipment purchases can result in a growing hard core of debt that can prove more costly to your business in the long run.

• A straightforward form of financing which leaves you in control of both the used equipment value and the claiming of capital allowances.

Finance lease

Although you never gain ownership of the agreement, a finance lease is similar to hire purchase in that you make regular fixed repayments over an agreed period, fully paying the cost of the equipment. A key difference is that VAT is payable on each lease payment rather than paying the full VAT due on the equipment at the outset of the agreement.

At the end of the primary leasing period, a nominal 'secondary lease period' annual payment is charged for continued use of the equipment. Alternatively, you can arrange for the equipment to be sold to an unrelated third party for which you will receive the full sales proceeds.

Another key difference to the hire purchase option is that while you cannot claim capital allowances, you are able to offset the lease repayments against any taxable profit.

Key benefits of finance lease (in addition to those for hire purchase):

• Enhanced business cash flow, with the ability to spread VAT across the life of the lease agreement.

• A straightforward form of leasing which leaves you in a position to control the used equipment value.

Thetford Golf Club invested in a new machinery package worth around £175,000 in 2008. Pictured here with Course Manager Paul Gould.

Operating lease and contract hire

Operating lease* is different to both hire purchase and finance lease options in that you do not repay the full value of the equipment over the rental period. You enjoy lower rental payments, paying only for what you use, rather than the full cost of purchasing the equipment.

At the end of the rental period you return the equipment.

However, as with the finance lease option, VAT is payable on each rental rather than at the outset of the agreement. Although you cannot claim capital allowances, you are able to offset rental payments against any taxable profit.

Additional key benefits of operating lease:

• Enhanced business cash flow with lower payments than for hire purchase or finance lease, and the ability to spread VAT across the life of the rental agreement.

• None of the uncertainty and effort associated with re-marketing used equipment, and the opportunity to develop a more planned equipment replacement cycle; this ensures that you can benefit earlier from the latest technology to enhance productivity.

Additional key benefits of contract hire:

• Known running costs; extending the principal of fixed interest costs, this type of agreement goes further and fixes all equipment usage and servicing costs for your business.

• Lower repair costs with preventive maintenance. Although a dealer maintenance plan will not cover the cost of repairs outside warranty, the likelihood of a major breakdown is reduced with more regularly maintained equipment.

It is also worth knowing that you can settle the contract early if required; depending on the type of agreement you have and the number of months that have lapsed, you may be given a rebate of interest for early settlement.

If you are rolling the outstanding financing into a new finance contract for the acquisition of new John Deere equipment, then you may be given additional early settlement rebates.

Summary

When deciding which finance product will best fit your needs, and what the tax implications are to your business, do consult your tax advisor.

You should bear the following points in mind:

• With hire purchase you can claim writing down allowances against any taxable profits, but with finance and operating lease you cannot.

• With finance lease and operating lease the lessor can claim the writing down allowances.

• With a finance lease you cannot own the equipment. However, at the end of the primary rental period you can continue using the equipment and pay a nominal secondary period rental. Alternatively you can arrange to sell the equipment for the lessor and receive a 100 per cent refund of the sales proceeds.

• With hire purchase you can offset the interest element of finance payments against taxable profits. With finance lease and operating lease you can offset the full rental against taxable profits.

• If tight cash flow or minimisation of capital employed is critical for your business, consider an operating lease or contract hire option. You only pay for what you use rather than the full cost to acquire the equipment. That means lower payments and no concerns about capital depreciation.