

## CAR FINANCE: ALL THE OPTIONS EXPLAINED

SHOULD I get one? Can I claim it on tax? What's the best way of getting one? Is my business too small to warrant one? These are some of the questions facing small or medium businessperson – especially if the car will be used for business and personal use. We examine some of the methods of getting a car, the different ways of doing it, and the things to consider. The golden rule, however, is to check with your accountant to make sure you're doing it the most effective way.

THERE are two main ways of financing a company car:

- **Lease** - Through a finance company, either direct or via a broker or car dealer.
- **Buy** - through either a Chattel Mortgage, Hire Purchase or a straight loan.

Each has advantages, depending on your company's circumstances, and each must be considered carefully.

Choosing the wrong method, or not taking your accountant's advice can cost thousands of dollars either in lost tax claims, or increased tax payments, such as GST or Fringe Benefits Tax.

One of the most important considerations is matching the terms and period of the payment from whichever method you choose to the expected useful life of the car and the cash flow of your business.

For instance, you don't want to be paying for a car over 10 years if it probably won't last that long. Or you don't want to pay out large amounts every month if your cash flow is seasonal, or varies a lot. Briefly, the matters to consider are:

### Lease

The basic test is – will the car earn a net increase in cash flow, or a net gain

in profit, over the tax deduction on the rental costs? If not, think again.

Salespeople will normally recommend this method. But beware, as they earn a bonus – a sale by lease earns the normal commission from the car, plus another on the finance package. For businesses, there are two main benefits:

- Conserving your own capital
- Tax deductions on the lease rental payments.

By leasing the business obtains a tax deduction for the lease rental payments, but the finance company or bank providing the lease retains ownership – and is able to claim the depreciation on it.

At the end of the lease, the business has the first opportunity to buy the car at its residual value.

If you don't buy it, and it's sold somewhere else at less than the residual value, you have to pay the difference.

Other advantages included:

- Payments are locked in – fixed in amount and time (though you can choose the time frame).
- The Purchase price must be 100 percent financed. The residual

or last payment must be within ATO residual guidelines.

- You do not have to pay GST upfront on the vehicle but the repayments include GST.

### **Hire Purchase**

The finance company retains ownership of the car until you pay it off, including interest.

The interest is tax deductible and you can claim a tax deduction for depreciation, even though technically you don't own it.

Hire purchase gives more flexibility because you can choose the size of the initial deposit, and the final payout amount, and even the period of payments.

An added flexibility for this is you can pay less in the earlier part of the loan, and then pay catch up payments latter on, or even a big payment at the end of the loan period.

Tax claims are more complicated, depending which accounting base you use – case or accrual. GST is payable on the purchase price of the car but not on the repayments.

Your accountant may be able to get your GST back in one lump sum depending on which product you use and which accounting basis your business uses.

### **Chattel Mortgage**

If you use a cash basis for your accounts, it would probably be better to take out a Chattel Mortgage as you can claim the GST back in the next BAS statement.

With a Chattel Mortgage the car is sold to you, ownership transfers to you – then you assign the title of the vehicle to the financier. Possession of the car remains with the customer and when the contract is paid out, the financier assigns back the title to you.

With hire purchase agreement, the car is sold to a finance company. then paid for by you, and ownership only transfers to you when the final payment is made.

### **Loan**

No need to explain how these work – most businesses have at least one on the go! However, in relation to a company car, the interest is tax deductible and you can claim depreciation. However, a bank or finance company might want you to put up a security against the loan.

### **Employees**

Another method is usually used as it has advantages and flexibility to suit both the boss and the worker, called a Novated Lease. Novated leases are popular for government employees.

A Novated Lease agreement is where an employee leases a car and then subleases (novates) it to their employer who pays the lease rentals.

The employer agrees to have the lease novated to them while the employee remains in their employment.

The employee remains fully liable for the debt and failure of the employer to pay the rentals constitutes default. If the employee leaves the company they retain the vehicle and can sublease it to a new employer.

### **Business Expense**

The employer is able to treat the lease rentals as a business expense despite the fact that the rentals made on behalf of the employee are not necessarily incurred in carrying on the business.

In this way the lease is a liability for the employee and does not affect the employer's balance sheets and borrowing capacity. Employees can generally choose the car they want (with-in reason). Also, if they change jobs, they retain the vehicle and can sub-lease the vehicle to a new employer.

The taxable value of the fringe benefit is calculated by considering the base value of the car, the number of kilometres drive, the amount of private use and any payment that the employee makes in consideration for the provision of a car such as the non-reimbursement of registration costs and insurance.

If the operating cost method is used, the taxable value of the fringe benefit is calculated by determining the portion of the benefit that relates to non-business use.

To determine the business use percentage, an employer is required to keep a log book each year for a minimum of 12 weeks outlining the dates and odometer reading for each business journey.

Private journeys do not have to be recorded. These records should be kept for at least five years.

### **Study the options**

Each option should be examined thoroughly to determine not only the tax benefits through deductions and depreciation, but also the net costs.

For instance, it's normal under a lease and hire purchase agreement that the user pays registration, insurance and maintenance costs, as well as stamp duty and statutory fees.

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