**Hire-Purchase Finance**

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**CONCEPTUAL FRAMEWORK**:
Hire-purchase is a mode of financing the price of goods to be sold on a future date. It is an agreement relating to a transaction in which goods are let on hire, the purchase price is to be paid in installments and the hirer is allowed the option to purchase the goods paying all the installments.
Though the option to purchase the goods/assets is allowed in the very beginning, it can be exer­cised only at the end of the agreement. The essence of the agreement is that the property in the goods does not pass at the time of the agreement but remains in the intending seller (hire-vendor) and only passes when the option is exercised by the hirer (intending hire-purchaser).
In contrast, in installment sale the ownership in the goods passes on to the purchaser simultaneously with the payment of the initial/first installment.
**Leasing Hire-Purchase**
1. Equipment etc., chosen from manufacturer As opposite; or direct from manufacturer. but leased from bank subsidiary leasing company.
2. Lessee never becomes the owner. The user becomes the owner — usually on on final payment.
3. No deposit required. Often 20% (or so) deposit called for.
4. Capital allowance claimed by lessor. Claimed by hirer.
5. Some allowance for (4) passed on by lesser Not relevant.
so that leasing rentals are reduced.
6. Lease can be ‘financial’ with a primary period Terms of H/P agreement can cover, items and thereafter continued leasing at nominal rent.

or
‘Operational’ where the items are often leased from the manufacturer being
responsible for the maintenance and upkeep of equipment.
7. The latter in (6) is advantageous for leased As opposite, but only if agreement allows items which are subject to technological users change/update items.
Under the down payment plan of hire-purchase, the hirer has to make a down payment of 20-25 per cent of the cost and pay the balance in equated monthly installments (EMIs).
As an alternative, under a deposit-linked plan the hirer has to invest a specified amount in the fixed deposit of the finance company which is returned together with interest after the payment of the last EMI by the hirer.
The hire-purchase installment has two components: (i) interest/finance charge and (ii) recovery of principal.
The interest component is based on a flat rate of interest while effective rate is applied to the declining balance of the original amount to determine the interest component of each installment.
During the hire-period, the hirer can opt for early repayment/purchase of the equip­ment/asset by paying the remaining installments minus an interest rebate.
The hirer has the right to terminate the contract after giving due notice.

**LEGAL FRAMEWORK**
There is no exclusive legislation dealing with hire purchase transactions in India.
The Hire-Purchase Act was passed in 1972. A bill was introduced in 1989 to amend some of the provisions of the Act.
In the absence of any specific law, the hire-purchase transactions are governed by the general laws. The hire-purchase transaction has two aspects: (i) an aspect of **bail­ment of goods** which is covered by the Indian Contract Act, (ii) an element of sale when the option to purchase is exercised by the hirer which is covered by the Indian Sales of Goods Act. The hire-purchase agreements also contain provisions for the regulation of hire-purchase deals.
**TAXATION ASPECTS**
There are three aspects of taxation of hire-purchase deals:

(i) income-tax,

(ii) sales tax and,

(iii) interest tax.
Though the hirer is not the owner of the asset, he is entitled to claim depreciation as a deduction on the entire purchase price.
He can also claim deduction on account of consideration for hire, that is, finance charge.
The amount of finance charge to be deducted each year is to be spread evenly over the term of the agreement on the basis of a method chosen from amongst the alterna­tives e.g. Straight Line Method.
The consideration is viewed as a rental charge rather than interest and no deduction of tax at source is made.
The hire-purchase transaction can be used as a tax planning device in two ways: (i) by inflating the net income (finance income — interest on borrowings by the finance company) at the rear-end of the deal and (ii) by using hire-purchase as a bridge between the lessor and the lessee, that is, introduction of an sales, are liable to sales tax.
However, hire-purchase trans­action structured by finance companies (which are not hire-vendors), being essentially a financing arrangement, do not attract sales tax.
An interest tax has to be paid on the interest earned less bad debts. The tax is treated as a tax-deductible expense for the purpose of computing the taxable income under the Income-Tax Act.
**ACCOUNTING AND REPORTING**
There was no accounting standard/guidance note for accounting treatment of hire-purchase in India. According to the current reporting practices, in the books of the hirer, the cash purchase price of the equipment is capitalized and an equal amount less down payment, if any, is recorded as a liability. The depreciation is charged on the cash purchase price in conformity with the general depreciation policy for similar assets.
As far as the finance company is concerned, the hire installment receivable is shown as a current asset under the head stock on hire.
The direct costs are expensed immediately/amortized over the accounting period. The ICAI has recently is­sued AS-19: Leasing, 2001. It defines leasing to include hire-purchase for accounting and reporting purposes.
**FINANCIAL EVALUATION**
The decision-criterion for evaluation of a hire-purchase deal from the point of view of a hirer is the cost of hire-purchase vis-a-vis the cost of leasing.
If the discounted cost of hire-purchase is less than the discounted cost of leasing, the hire-purchase alternative should be preferred and vice versa.
The preference for the alternative implies that the equipment should be acquired under that alternative. The decision-criteria from the viewpoint of the financial intermediary is based on a comparison of the NPVs of the hire-purchase and the leasing alternatives. The finance company would choose the financing plan with higher NPV.

**Advantages**

HP or leasing allows companies to control and deploy assets without significant drain on working capital fixed-rate funding makes budgeting easy as the lessee has clear sight of future expenditures flexibility of repayment structuring is available to allow for seasonal business (eg. one repayment a year), and to reduce monthly outlay by factoring in a ‘balloon’ payment at the end of the term leasing prevents the risk of an asset’s value depreciating quickly and provides flexibility to enter into a new contract at the end of the original lease’s fixed term financing asset purchases can be more tax efficient than standard-term loans due to lease payments being booked as expenses.

Although asset depreciation also provides tax benefits, the useable lifetime of the asset will vary depending on the asset and on local regulation high accessibility of financing for businesses due to the financing being secured with the leased asset and the asset being owned by the financing company in certain circumstances there is maintenance included within the terms of the agreement.