Accounting for Hire Purchase Agreements

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Hire purchase ('HP')is a common form of financing assets on the farm, but it often isn't clear how it should be treated in the books. This guide tells you what you need to know.

What is Hire Purchase?

Hire purchase is a form of finance. Essentially you have bought the item and used a loan (from the finance company) to pay for it.

With HP you are considered the owner of the item immediately, the item appears as an asset on your balance sheet, and the balance owing to the finance company appears as a liability. When you buy an asset with hire purchase you are able to reclaim all of the VAT at the outset.

HP is different to leasing, which is more like a long term hire of an item which you never own. Leasing can be easier to account for as you simply reclaim the VAT on the lease/hire charge each month.

Accounting for HP

The simplest way to account for a hire purchase agreement is to think about what has actually happened, and account for the various individual elements in the normal way.

1. You have bought an item (normally of plant & machinery), perhaps from a machinery dealership. You will want to process a transaction for the purchase of the item, and account for the VAT in the normal way.
2. You have bought the services of a finance company, who may charge you interest and will probably charge you fees (documentation fee, option to purchase fee, etc). You will process a transaction for the charge of these fees, and whilst you account for VAT in the normal way remember that finance costs are normally **exempt** from VAT.
3. You have taken out a loan from the finance company. The cost of the item purchased from the dealer, and the fees, interest etc from the finance company, are both paid by this loan.
4. The repayments you make to the finance company, both any initial one-off sums and the regular payments, will be repayments to this loan.

Your accountant or software provider can advise about the quickest way to process the transaction in your system.

"What if there's a part-exchange?"

If you are part-exchanging a piece of equipment then you are **selling** an item, and need to charge VAT on in the normal way. So on your VAT return you will have a transaction for the item you are buying (and reclaiming the full amount of VAT), and a transaction for the item you are selling (and paying the full amount of VAT).

"I've given the dealer a cheque for the VAT."

No you haven't! This is a very common misconception and often creates confusion about how to account for the item. You have actually paid the dealer a deposit equal in amount to the net amount of VAT you will reclaim from HMRC.

As far as your VAT records are concerned you still need to account for purchase of the new item in full, and account for the sale of any part-exchanged item in full.

This guide does not constitute advice— for advice about your business finances contact your accountant.

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