

Unit – 6

Leasing and Hire Purchasing

Leasing

- A contractual arrangement in which owner of an asset (lessor) transfers the right to use the asset to another party (lessee) for an agreed time for consideration in the form of periodic rentals.
- At the end of the lease the asset goes back to the lessor and the contract is renewed.

As per IAS -17 lease is “an agreement where by the lessor transfers the right to use an asset for an agreed time in return for rent the right to use an asset for an agreed time.”

Features

- Parties must be competent to contract
- No transfer of ownership to the lessee
- Goods are transferred for a specific purpose
- Lessee should return exactly the same goods
- Lease rentals are payable in monthly installments
- Equipment leases are for capital investment not exceeding 80%
- Equipment leasing covers a wide range of equipments such as machinery, vehicle, office equipment, computers, automobiles etc.

Parties involved in Lease

Lessor

Owner or lender

Specialised leasing companies

Banks

Specialised financial institutions

One-off lessors

Manufacturer lessors

Lessee

User or renter or tenant

Corporate customers

PSUs

Consumers

Mid cap companies

Commercial vehicles

Earth-moving machinery customers

Govt departments

Contents of Leasing agreement

- Particulars of the parties
 - Description of the asset
 - Effective date, Primary period and renewal
 - Initial deposit, rental and payment terms
 - Manufacturer's warranty
 - Ownership
 - Delivery and installation terms
 - Repair and alteration
 - Insurance
 - Sub-lease
 - Surrender
 - Default
 - Arbitration
 - Taxes and govt dues
 - Termination clause
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- Restricted activity

Steps in Leasing agreement

- Lessee has to decide about the type of asset required
- Lessee has to determine the manufacturer of the asset
- Lessee has to enter into a lease agreement with regard to
 - irrevocability during basic lease period
 - amount and timing of rental payment
 - option of renewal/purchase at the end of the basic lease
 - responsibility to pay for repairs, taxes, insurance, expenses
- After the agreement manufacturer has to supply the asset
- After the asset is delivered and accepted by the lessee, the lessor has to make payment to the manufacturer.

Types of Lease

- Operating or service lease
 - Financial lease
 - Sale and lease back
 - Direct Lease
 - Bipartite lease
 - Tripartite lease
 - Single investor lease
 - Leveraged lease
 - Domestic lease
 - International lease
 - Import lease
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- Cross boarder lease

Legal Frame work

- No separate statue regarding leasing
- Laws relating to bailment are applicable
- Provisions of the sections 150-168 of the Indian contract act are applicable
- Lessor has the duty to deliver the asset to the lessee
- Authorise the lessee to use the asset
- Leave the asset in the possession of the lessee
- Lessee has obligation to pay the lease rentals as specified in the lease agreement
- Lessee has the obligation to protect the lessors title to the asset
- Take reasonable care of the asset
- Return the leased asset on the expiry of the lease period

Advantages and disadvantages of leasing – Presentation
Legislative framework relating to Depreciation and
Presentation by Karon D'souza & Sharon D'souza

Advantages of Leasing

To the Lessor

- Full security
- Tax benefit
- High Profitability
- Trading on Equity
- High Growth potential

To Lessee

- Financing of capital goods
 - Additional source of finance
 - Less costly
 - Ownership preserved
 - Avoids conditionality
 - Flexibility in structuring of rentals
 - Simplicity
 - Tax Benefits
 - Obsolescence risk
 - Other benefits
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Problems in Leasing

- Resource constraint
- Risk of obsolescence
- Non availability of sales tax consideration
- Cut-throat competition
- Lack of qualified personnel
- Delay in rental payment
- Attitude of government

Factors influencing buy or borrow decision

- Capital and cost of borrowing
 - Availability of freehold or leasehold interest
 - Interest on capital employed
 - To show increase in capital
 - Taxation
 - Obsolescence risk
 - Future returns
 - Depreciable asset
 - Non-depreciable asset
 - Other factors
 - Operating factors
 - Legal factors
 - Financial factors
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Hire Purchase

A contract of hire between a vendor and a purchaser, with an option to purchase the asset at the end of fixed term of hire; by the purchaser provided he pays regular rentals regularly.

Terms: Payment will be made in instalments, Possession of the asset is transferred to the buyer immediately, ownership remains with the vendor until the payment of last instalment, Seller can repossess the goods if the buyer defaults on the instalment, each instalment is treated as hire charges till the last instalment is paid.

Features

- Transfer of asset from vendor to hire purchaser immediately at the beginning of the contract
- Purchaser pays agreed rentals at agreed intervals to the vendor
- Vendor continues to own the asset till the last instalment is paid by the purchaser.
- Hire purchaser may make a down payment upon signing the agreement
- If the purchaser defaults a payment, even the last one, the vendor has the right to take back the asset without having to pay any compensation.

Contents

- **Nature of agreement:** stating the nature, term and commencement of agreement
- **Delivery/handing over of assets:** place, time of delivery of asset and who will pay the delivery charges, installation responsibilities etc
- **Location:** place where the asset will be kept during the period of agreement.
- **Inspection:** the hirer has examined the equipment and is satisfied
- **Insurance:** that the hirer will pay for insurance and hand over the policy to the owner.
- **Alterations:** the hirer is not authorised to make any alterations/modifications to the machinery without prior consent of the owner.
- **Repairs:** the hirer will pay for all repairs required during the contract period.

- **Termination:** what conduct of the hirer would lead to a termination of the agreement?
- **Risk:** risk of damage and loss to be borne by the hirer
- **Indemnity clause:** clause which necessitates the hirer to make good the loss/damage incurred by the lender on the asset
- **Stamp duty:** the hirer will pay the stamp duty
- **Registration and fees:** the hirer is responsible to follow all legal formalities, necessary registrations and pay the fees
- **Schedule:** schedule of equipment, hire charges etc forming part of the agreement
- **Guarantee:** usually the agreement is accompanied by a bank guarantee or a promissory note given by the hirer for the full amount of the hire including interest and finance charges.

Banks and Hire Purchase

- Banks extend consumer loans and instalment credit to buyers and sell
- Not been able to extend credit to hire-purchasers directly. Hence provide credit to owners or refinance financing companies or associate of manufacturers against hire-purchase contracts
- In case of commercial vehicles banks extend OD or cash credit against hypothecation of first charge of vehicles covered under hire-purchase agreements. Also, secured by indemnity insurance policies in favour of banks
- Banks maintain a margin of 25%-30% on instalments due by hirers to banks
- They usually do not accept hire agreements of amounts exceeding Rs. 10 lakhs

IDBI

- IDBI indirectly participates in hire-purchase business by way of discounting of promissory bills/promissory notes arising out of sale of indigenous machinery on deferred payment basis.
- Under the IDBI scheme bills/promissory notes should be drawn in favour of manufacturer who can discount them at banks and other financial institutions who can further re-discount them at IDBI.
- Deferred payment period is generally up to 5 years or 7 years under hire-purchase cases.
- Manufacturers of cotton and sugar machinery, machine tools, agricultural machinery, oil solvent extraction plants, and some other agro industries can use of this facility.

Difference between Leasing and Hire purchase

- Down payment
- Reporting
- Maintenance of Assets
- Sustainability
- Nature of Assets
- Receipts
- Income

Difference between Installment sale and Leasing

- Nature
 - Ownership of the assets
 - Tax Benefits
 - Appearance in the Balance sheet
 - Overall cost of the Asset
 - Duration
 - Maintenance support of the Asset
 - Reduced initial cash outlay
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Comparison of Hire purchase with Credit Sale

- Governing Act
- Ownership
- Payment
- Interest
- Repossession
- Termination of the contract
- Risk of loss
- Sales tax

Link for you tube video

<https://www.youtube.com/watch?v=PD8XV8Pvy0E>