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Comparison of Machinery/Vehicle Finance By Chattel Mortgage or Leasing

Apart from paying cash, there are several ways to finance the purchase of plant, machinery and vehicles used in your farm or business. The following outline assumes 100% business use.

Leasing

Under a lease contract, the financier (**lessor**) buys the asset from the dealer and makes it available to the user or **lessee** for a set period of time in consideration for a regular rental instalment. The financier retains title to the item although the lessee takes possession.

At the end of the lease period the item is usually sold (at its predetermined or **residual** value) to the user although this is not always the case. It may be sold on the open market but if there is a shortfall, the user has to pay the difference.

Chattel (or 'goods') mortgage

This is more like a bank loan than a lease arrangement. It may also be called an **equipment loan**, or **bill of sale**.

In effect, the user buys the item and takes title to become the owner of the item. The financier then "reimburses" the owner (mortgagor) for the value of the item. Generally the money flows directly from the financier to the dealer after the owner has signed a **disbursement authority**.

The financier's security for the loan is a mortgage over the item of machinery, and they receive repayments from the user, determined at the signing of the contract.

Standard loan (e.g. term loan or overdraft)

The item being purchased is not used as security. Instead the financier will take security over what they always use - bricks and mortar or farmland.

GST IMPLICATIONS UNDER A LEASE CONTRACT

There are actually **two** GST transactions...

- First, the dealer makes a taxable supply of the item of machinery to the financier (owner).
- Second, a financing arrangement is made between the financier and the user.

For the user (lessee) under a **lease** contract, GST is payable on the taxable supply of the machinery for an agreed periodic rental payment (e.g. annually, monthly) including GST.

On each activity statement you report payments you made in that tax period for leased goods. That is, you treat each payment as though you are making a separate purchase each tax period, even though each payment is for the same goods under the same lease agreement.

GST UNDER A CHATTEL MORTGAGE OR STANDARD LOAN CONTRACT

There is only **one** GST transaction…between the user (owner) and the dealer.

- The other contract between the financier and the user is a **GST-free financial supply**.
- The user claims the GST up front per the tax invoice (in the first BAS after the item is purchased).

INCOME TAX CONSIDERATIONS FOR THE VARIOUS OPTIONS

Lease

- The lease payments are fully deductible in the year of payment if you are a **Small Business Entity** (SBE) with a turnover of less than ten million dollars.
- Other taxpayers are subject to **prepayment rules** resulting in a pro-rata deduction.
- At the conclusion of the lease a "residual" payment (including GST) is made at which point you become the owner. This amount is taken into the depreciation schedule as the "cost" of the item to be depreciated.
- The residual amount must meet the minimum residual values. A partial extract is shown in the table below:

Equipment/vehicle type	**Residual value % for term**		
	3 years	**4 years**	**5 years**
Cars	46.88%	37.5%	28.13%
Ute Header Tractor	56.25%	50%	43.75%
Truck	60%	55%	50%
Generally – non-motorised farm equipment	60%	55%	50%

Chattel mortgage or standard loan

- The cost price of the item is taken up in your depreciation schedule and depreciated accordingly.
- The interest component of each repayment is tax deductible in the year of payment.

TAX IMPLICATIONS ON DISPOSAL OF CAR OR MACHINERY

Non-SBE taxpayers (If your turnover is greater than $10m for two consecutive years) depreciation recouped on disposal (i.e. where proceeds exceed the tax written down value) must be brought to account as taxable income.

However, if you are a SBE and use the SB depreciation pools, then proceeds of the sale of business assets will reduce your depreciation pool balance and therefore would not be assessable income unless the proceeds create a credit balance in your pool. Full proceeds from sale of items that have been claimed as a 100% Immediate write-off are taxable income when sold or traded.

Due to recent Government changes to depreciation rules, it is worth considering whether a different finance method should be used for new asset purchases.

- Before buying or selling any depreciable item please contact us for a tax opinion.