

CONTRACT HIRE.

Contract hire is a vehicle funding product designed to allow the client to budget the expense of running a vehicle as a fixed monthly cost over the total period of its use. The client enjoys a “risk free” package eliminating the concerns involved, such as the future value and maintenance cost controls which can be a variable and unpredictable expense to their company or business.

A contract hire rental is based on the make and model of the vehicle, the period of use, the amount of anticipated mileage likely to be covered and whether full or supplementary services are to be included. The most common types of contract hire package are either with or without maintenance, and are usually determined by the client’s mileage requirements over their desired period of use.

Where maintenance is required the client enjoys maintenance and servicing of the vehicle, including replacement batteries, tyres and exhausts, road fund licence, replacement vehicle and full breakdown services. All of these are included in the rentals and are fixed, risk free running costs to the client.

Because the rentals are fixed for the contract period they provide clear information enabling more accurate budgeting for the client. This is further enhanced by the control of cash flow as well as administration burdens normally experienced through the management and processing of vehicle operating requirements, particularly when full maintenance needs are taken into consideration.

Contract hire is simply an honest and pragmatic approach to handling the funding of company vehicles and managing the expenses involved in a controlled and realistic way.

Contract hire provides “off balance sheet” funding for vehicles and can prove useful for the purposes of strengthening a company’s balance sheet.

For business users who require reliable fleet operations that reduce costs and administration it provides a continuity of service that enables management to spend their valuable time on productive matters concerning the welfare of their own business.

At the end of the contract period the vehicle is simply returned and a new vehicle contract is entered into by the client as required. Providing the client has not exceeded their contract mileage and the vehicle is not returned damaged there are no further costs incurred by the client.

VAT.

On August the 1st 1995 the treatment of VAT changed concerning vehicles subject to contract hire, that were registered from that day onwards. Because the company is buying the vehicles for 100% business use only (to finance lease to our clients) we are able to recover the VAT on the purchase price of the vehicle, this means lower interest charges for the client when calculating rentals. However, the client can, in turn, only recover 50% of the VAT charged on the monthly rental for contract hire excluding maintenance. Where the client has full maintenance with contract hire, the maintenance element is 100% VAT recoverable. The 50% of VAT that is non-recoverable from the funding portion of the contract hire rental can be 100% allowable against corporation tax.

It is possible to recover 100% of the VAT on the total finance lease rental if the client can prove categorically that the vehicle has been used only for business purposes. The company will be able to provide the best advice on the day to clarify such issues when they affect any clients VAT treatment relating to contract hire vehicles.

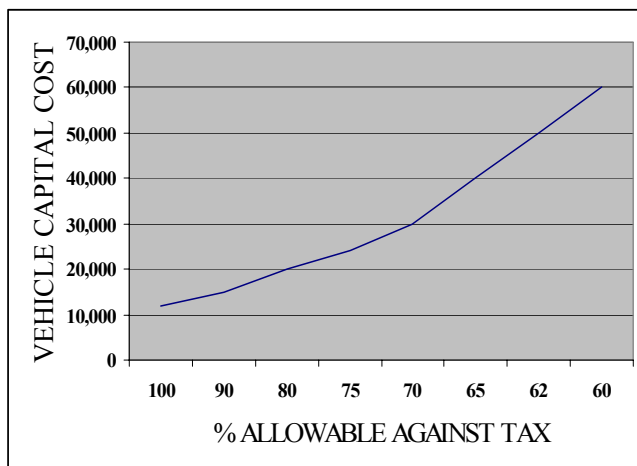
TAX TREATMENT.

Under the current rules laid down by the Inland Revenue any vehicle that is operated under a contract hire agreement, costing in excess of £12,000, suffers a “tax disallowance” on rentals in line with the “half the excess” formula as illustrated below:

$$\frac{12,000 + \frac{1}{2}(\text{Capital Cost} - 12,000)}{\text{Capital Cost}} = \text{Percentage Allowable}$$

If the vehicles capital cost is £12,000 or less then the contract hire rentals (irrespective of whether they are including or excluding maintenance) are 100% allowable against tax. This applies whether the rental amount is £100 or £1,000 per month. This can be very advantageous as it has the effect of accelerating tax allowances to the benefit of the client. For example, if a vehicle were to be contracted under a finance lease at £450 per month then the amount allowable against tax would be £5,400 (12 x £450) as opposed to £3,000 capital allowance had the vehicle been acquired through cash or hire purchase. When this effect is multiplied across a number of vehicles or a large fleet the tax benefits can become extremely significant, reducing the client’s tax bill substantially.

However, this formula has a reducing effect on the tax efficiency of a contract hire vehicle the more expensive the capital cost of the vehicle becomes. Therefore, there will be a point where the capital cost of the vehicle will render finance lease tax inefficient despite the effect of accelerated allowances that finance lease provides. The graph below illustrates the percentage of the contract hire rental that would be allowable against tax in relation to the increased capital cost of the vehicle.



Because every client has different circumstances, priorities and requirements there are no hard and fast rules in establishing when, where and at what point contract hire becomes an unsuitable vehicle-funding product. Although tax is not the only issue Peter Holt Ltd can advise a client as to what their position would be having taken the client’s aims and objectives into account.

SUMMARY OF BENEFITS.

- Any Vehicle make and model
- New or Used vehicles
- Cost Effective
- Risk Free
- Improved Cash Flow
- Protects Working Capital
- Off Balance Sheet Funding
- Additional Credit Line
- Driver Convenience
- Accelerated Tax Allowances
- Improved Budgeting
- VAT Efficient
- Administration Free
- Releases Management Time