

## Introduction

Many traders finance their fixed asset requirements through finance leasing. The trader leases the asset for a fixed period (the primary period) with an option to lease for a further period. At the end of the lease, the finance company sells the asset at market value and refunds this amount (less any amounts still owing on the lease) to the lessee, i.e. the person who leases the asset. The trader may receive the rebate by direct payment, may use it to purchase the asset that had been leased or may use it as an up-front payment against a further leased asset.

This leaflet outlines the tax treatment of finance leases for lessees.

### Lease Payments

The lessee is allowed a deduction for lease payments in calculating profits for tax purposes. Payments under a lease can be either:

- ◆ ordinary recurring payments - usually payable monthly, or
- ◆ initial leasing payments, i.e., an up-front payment by the lessee, followed by recurring payments. *The up-front payment may be:*
  - ⇒ a lump sum payment in cash at the beginning of the lease, or
  - ⇒ a trade-in of an asset already owned by the trader, or
  - ⇒ a rebate of lease rentals on an asset which was previously leased by the trader.

### Primary Period

Most finance leases operate for a primary period during which the taxpayer effectively pays for the asset. At the end of the primary period, the lessee has the option to extend the lease for a further period.

**For tax purposes, all lease payments, including up-front payments, are spread evenly over the expected period of the lease (i.e. the period during which it is expected that the asset will be leased).**

Revenue will generally accept that payments may be spread over the primary period of the lease, where the primary period is standard for the type of asset in question and it is not clear at the start of the lease that the asset will be leased for a longer period. In practice, the primary period should not be less than three years. For example, where there is a primary period of, say, four years (which is standard for the type of asset), and the lessee does not plan to opt to lease the asset beyond that time, lease payments should be spread over four years.

### Advance Payments

Many finance companies require lessees to pay a number of instalments of lease payments in advance. Spreading of such advance payments could unnecessarily complicate the preparation of tax returns, where the amounts are not material. Where such a payment in advance does not exceed three months lease payments and all other payments under the lease are spread evenly over the period of the lease, however, it will not be necessary to spread the advance payment.

### Seasonal Trades

In seasonal trades, to comply with the principle of matching income with associated costs, lease payments may be spread on a seasonal basis. Where the expected period of a lease corresponds effectively to the seasons during which the asset will be used, lease payments may be spread evenly over the tax years corresponding to those seasons.

### Example 1

An agricultural contractor, who prepares accounts to 31 December annually, takes out a three year lease on a combine harvester in August 2004. Under the lease, one annual lease payment is to be made in August of each year of the lease (to correspond with the harvesting season). A deduction for the August 2004 lease payment may be taken in the accounts year ended 31 December 2004 which forms the basis for the income tax year 2004.

### Lease Termination

At the termination of a lease:

- ◆ the asset is returned to the leasing company, or
- ◆ the lessee purchases the leased asset, or
- ◆ the lessee trades-in the asset, i.e., uses the rebate of rentals as an up-front payment against another leased asset.

### Asset returned to the leasing company

Where the asset is returned to the leasing company, the leasing company gives a rebate of rentals to the lessee. The rebate is approximately the market value of the asset.

**The rebate of rentals must be included in the profits of the period in which it is received and is taxed accordingly.**

### Lessee purchases the leased asset

Where a trader purchases the leased asset at the end of the lease, the leasing company sets the rebate of rentals against the cost of the asset to the lessee (market value). This is instead of giving the rebate to the lessee as a cash payment. **Again, the rebate of rentals is taxable in the period in which it is received. The trader can claim Capital Allowances on the cost of the asset, i.e., market value at the date the lease ends, from the time the asset is purchased.**

## Example 2

At the termination of a lease in the basis period for 2004, the market value of the leased asset is €15,000. The lessee opts to purchase the asset. The finance company refunds the market value €15,000 to the lessee (less a small transaction cost) by way of credit against the cost of the asset. The lessee is chargeable on the €15,000 for 2004 and may claim Capital Allowances on the asset for that and subsequent years.

### The lessee trades-in the asset

The rebate of rentals on the old leased asset is set against the cost of the new leased asset. In other words, it is used as an up-front payment for the new asset.

- ◆ The amount of the rebate is taxable in the period in which it is received.
- ◆ The up-front payment, i.e., the rebate, is spread evenly over the expected period of the new lease (see paragraph headed “Lease Payments”).

## Example 3

Assume the asset in **Example 2** is used as a trade-in against a further leased asset with an expected lease period of four years. The rebate of €15,000 is taxable in 2004 and the up-front payment is spread over four years, i.e., the lessee claims €3,750 per annum for 2004 to 2007 inclusive.

### Motor Vehicles

There is a restriction on the amount of lease payments allowable for tax purposes on private motor vehicles. Where the retail price of the vehicle at the time of manufacture exceeds the relevant Capital Limit\* the allowable lease payments are restricted to:

$$\frac{\text{Lease Payments} \times \text{Relevant Capital Limit}}{\text{Retail Price of Vehicle}}$$

Where a rebate of rentals arises and the lease rentals have been restricted, the lessee is taxed only on the

proportion of the rebate that has been allowed for tax purposes. Any deferred charges are similarly restricted.

\*The current amount of the relevant Capital Limit can be obtained from any Revenue office (see note headed Further Information below).

### Corporation Tax

While the examples in this leaflet refer only to Income Tax, the same principles will be applied in relation to Corporation Tax.

### Further Information

This leaflet is for general information only.

Further information can be obtained from Revenue's website [www.revenue.ie](http://www.revenue.ie) or by contacting your local Revenue office. An up-to-date listing of all Revenue offices, contact numbers and e-mail addresses is available on Revenue's website.

**Taxpayers are advised to take professional advice on the tax consequences of finance leases before entering into such leases.**

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