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Leasing

When leasing an asset, the leasing company (the lessor or owner) buys the asset and rents it to the hirer or lessee for an agreed period. The accounting and tax treatment depends upon whether the lease is a finance lease or an operating lease.

Finance lease

These agreements usually run for all, or a substantial proportion, of the asset's working life. Consequently, the lessor transfers all of the risks and rewards of ownership of the asset to the lessee, which is similar to the position they would be in if they had bought the asset.

The balance sheet accounting treatment of a finance lease therefore follows a hire purchase agreement in that the asset is put on the lessee's balance sheet. Tax-ownership of the asset however remains with the lessor in substantially all agreements with a term of less than seven years. The lessor therefore claims the capital allowances and the lessee obtains a deduction from profits for the rentals paid.

Operating lease

These agreements generally do not cover all or nearly all of the asset's working life. Consequently, it is the lessor (leasing company) which retains the risks and rewards of ownership, and the asset would not be shown on the lessee's balance sheet at all.

The taxation treatment is the same as for a finance lease in that the lessor charges the lessee a rental for use of the asset, and this is deducted from the lessee's profits. It is important that businesses understand what types of asset finance agreements are on offer and what the tax implications and associated benefits of each are.

IFRS 16, the International Accounting Standards Board's (IASB) new leasing standard will not come into effect until January 2019.

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