BOOKKEEPERS
KNOWLEDGE
BASE

Edition 23

Financing Motor Vehicles

INTRODUCTION

One of the most common decisions facing business is how to finance and account for the acquisition of a motor vehicle. There are numerous ways that can be used and each way can result in differing accounting, taxation and GST treatment.

Throw in the dilemma of the Motor Vehicle Depreciation Limit and you have the potential for over claiming depreciation (decline in value) and GST.

The objectives of this Knowledge Base are to:

- Consider a number of the more common means of financing the acquisition of a motor vehicle
- Look at the accounting and income tax connotations of using the various methods
- Look at the impact each form of financing has on claiming input tax credits, and
- Consider the Motor Vehicle Depreciation Limit and its impact on the purchase of a vehicle through the various financing regimes.

ACQUIRING A MOTOR VEHICLE

One of the most common questions asked in relation to motor vehicles is how should I go about purchasing a vehicle? While it may seem a relatively straightforward question, there are numerous ways of doing so and the decision can have vastly different outcomes for income tax purposes, GST and cash flow.

Some of the more common methods are:

- Outright Purchase,
- Lease,
- Hire Purchase, or
- Chattel Mortgage.

We will now consider each of these four methods and their differences.

Important Note: The following discussion does not consider a vehicle that exceeds the Motor Vehicle Depreciation Limit of $57 581 (2017/2018). The Motor Vehicle Depreciation Limit is considered later in this bulletin. We also are only considering the various methods as they relate to GST registered entities.

The Motor Vehicle Depreciation Limit should not be confused with the Luxury Car Tax Limit, even though in previous years they have been the same amount. Luxury Car Tax (LCT) applies when a vehicle is sold and exceeds the Luxury Car Tax limit of $65 094 (2017/2018). Luxury Car Tax is calculated, reported and paid to the ATO by car dealers and manufacturers, not by businesses purchasing a vehicle. For businesses purchasing a luxury car, the LCT is simply part of the purchase price.

For a business able to use the Simpler BAS, only **G1** (total sales), **1A** (GST collected) and **1B** (GST paid) are actually reported. **G10** and **G11** are not reported on, but for completeness sake we will continue with the details to demonstrate how the figures flow through to **1B** on the BAS.

Outright Purchase

The advantage of purchasing a vehicle outright, as opposed to financing the acquisition of the vehicle, is that there will be no ongoing costs of finance. This may not be such a big issue in these times of relatively low interest rates. It wasn't that long ago, however, that interest rates were in the high teens, which would have substantially increased the monthly payment and added significant cost to the overall purchase price.

In contrast, however, the outright purchase of a vehicle can impact greatly on the cash resources of an entity when those funds may be better utilised elsewhere. It is far easier to obtain finance for the acquisition of a vehicle than it is for the acquisition of trading stock. Care should therefore be taken not to cripple the entity's cash flow if considering an outright purchase.

When acquiring a vehicle, the costs involved in the actual purchase are usually the same. The components typically shown on a purchase invoice from a motor dealer are:

- Deposit,
- Cost of Vehicle,
- Dealer Charges,
- Stamp duty,
- CTP Insurance,
- Registration, and
- GST.

In addition, there may be some after market accessories purchased with the vehicle such as headlight and bonnet protectors, bull bars, towbars, seat covers, rust proofing, etc. These all add to the total price paid for the vehicle and must be accounted for in the transaction.

Consider the following example:

Example 1

Michael acquires outright a new Holden Barina and receives an invoice from the Dealer showing the following:

New Vehicle Price	15 900.00
Air Conditioning	1 809.09
Roof Racks	310.00
Dealer Delivery Charge	695.45
Discount Given	(1 717.27)
Subtotal	16 997.27
On Road Costs:	
Stamp Duty	398.00
Registration Fee	245.00
CTP Insurance	390.00
Vehicle Total	18 030.27
GST in Price	1 699.73
Total Due	19 730.00

(CTP Insurance includes $31.62 GST)

The first step in accounting for the acquisition is to identify the different components that make up the total purchase price of $19 730. We need to identify the asset cost, any deductible expenditure and finally the GST in the transaction.

In this instance, the asset cost is made up of a number of amounts. There is the first element cost of the asset being the vehicle itself as well as a number of second element costs being the after market accessories that have been purchased with the vehicle (Air conditioning & Roof Racks). While the air conditioning would attach to the vehicle, the roof racks could be held separately from the asset and hence need to be treated as a separate asset on an asset register. The dealer delivery charge and the discount given are in respect to the vehicle and hence add to and subtract from the first element cost of the vehicle. In addition, the Stamp Duty paid in respect of the vehicle is also considered an incidental cost of purchase and as such is attributed to the cost of the vehicle.

The assets acquired are therefore:

1. Vehicle

Cost of Vehicle	15 900.00
Air Conditioning	1 809.09
Dealer Delivery Charge	695.45
Less Discount	(1 717.27)
Stamp Duty	398.00
Asset Cost	**17 085.27**

(Note that Stamp duty is outside of the scope of GST and has a tax code N-T.)

2. Roof Racks **310.00**

Items that are considered to be deductible expenditure include:

Registration fee 245.00

CTP Insurance	358.38
Total Expense	**603.38**

(Note that the GST included in the CTP is deducted in order to determine the expense amount)

Finally, the GST is identified:

GST on Vehicle and Accessories (excluding stamp duty)	1699.73
GST on CTP Insurance	31.62
Total GST	**1731.35**

Having identified the various costs that make up the transaction, the next step is to account for them within your system. Remember that in this instance the purchase has been made outright and as such the business will have written a cheque or transferred a cash sum for the amount of $19 730.

Account	Tax Code	Debit	Credit
Asset – Motor Vehicle	CAP	16 687.27	
GST Paid	N-T	1 668.73	
Asset – Motor Vehicle	N-T	398.00	
Asset – Roof Racks	CAP	310.00	
GST Paid	N-T	31.00	
Expense – M/V Registration	N-T	245.00	
Expense – M/V Insurance	GST	316.20	
GST Paid	N-T	31.62	
Expense – M/V Insurance	N-T*	42.18	
Bank Account	N-T		19 730.00

(Where CAP=Taxable Capital purchase; GST=Taxable purchase; N-T=outside the scope of the GST system.)

* denotes the component of CTP Insurance outside the scope of GST. The GST paid has been shown in separate lines in the above journal entry to show how the GST components have been calculated.

Lease

Rather than choosing to acquire the car outright, the business may elect to finance the acquisition of the vehicle. The central issue that surrounds any form of financing, and how it is to be accounted for, is whether the person providing the asset under the finance arrangement is the legal owner of that asset. This issue goes to the heart of how the finance transaction is to be treated and is often the subject of Tax Office scrutiny. The Tax Office has warned taxpayers about the trap of claiming deductions for what appear to be lease payments when in fact the finance arrangement is a Hire Purchase or similar type of transaction. The only way to identify the difference is to read the terms and conditions of the finance agreement.

The Tax Office will consider a finance arrangement to be a lease when:

- There is no option to purchase the vehicle written into the agreement; and
- The residual value reflects a bona fide estimate of the vehicle's market value at termination.

If these two conditions are not met, the Tax Office considers the finance agreement to be a Hire Purchase or other instalment type agreement.

In effect, a leasing document identifies the owner of the vehicle as being the lessor with the lessee merely renting the vehicle from them for regular fixed instalments.

It is important to identify which method of finance is used to acquire the vehicle for the following reasons.

Under a leasing arrangement, the lease payments are a deductible amount to the extent the vehicle is used for income producing purposes, and the financed sum is not typically booked on the balance sheet of the entity.

Where the financing arrangement is not considered a lease, the vehicle is booked as an asset on the balance sheet and depreciated. In addition, the finance sum is booked as a liability and that component of each repayment that represents interest is expensed and the remaining principal reduces the liability.

Under a leasing arrangement, the first payment typically provides for the on road costs to be added to the amount of the regular payment that forms the acquisition of the vehicle.

Example 2

Assume that Michael from Example 1 finances, via a lease, the acquisition of the Barina. Assume also, that the repayments for the lease will be for a sum of $415.00 per month plus a residual sum after 3 years of $6 000. Assume the on road costs remain the same i.e. Stamp duty $398.00, Registration $245.00 and CTP Insurance of $390.00 including $31.62 GST.

Accounting for the lease is relatively straightforward. The first payment will be for a sum of $1 448 being the regular monthly sum of $415.00 together with the on road costs totalling $1 033. The regular monthly lease payment will also attract a stamp duty component that is embedded in the amount and can be readily identified from the leasing documentation. We will assume this amount to be $5.00. This stamp duty amount is a cost of borrowing, is deductible but does not attract GST. The remainder of the sum is subject to GST, and one eleventh of the regular repayment may be claimed as an input tax credit. Therefore, of our remaining monthly repayment being $410.00, the GST included in this amount is $37.27.

As the lessee is not the owner of the vehicle, the tax invoice for the purchase of the vehicle would go to the leasing company who would deal with making the claim for any GST on the purchase price of the car at their end. In effect, when a vehicle is financed under a lease arrangement, the amount financed is the GST exclusive price of the goods.

The entry required to account for the vehicle lease is therefore limited to each instalment made.

First instalment:

Account	Tax Code	Debit	Credit
Expense – Lease Expense	GST	372.73	
GST Paid	N-T	37.27	
Expense – Lease Expense	N-T	5.00	
Expense – M/V Registration	N-T	245.00	
Expense – M/V Insurance	GST	316.20	
GST Paid	N-T	31.62	
Expense – M/V Insurance	N-T*	42.18	
Asset – Stamp Duty Leased M/V	N-T	398.00	
Cash At Bank	N-T		1 448.00

(Where GST=Taxable purchase; N-T=outside the scope of the GST system.)
** = component of CTP Insurance outside the scope of GST.*

Subsequent instalments:

Account	Tax Code	Debit	Credit
Expense – Lease Expense	GST	372.73	
GST Paid	N-T	37.27	
Expense – Lease Expense	N-T	5.00	
Cash At Bank	N-T		415.00

(Where GST=Taxable purchase; N-T=outside the scope of the GST system.)

On payment of the final instalment, the lease company would give you the choice of acquiring the goods or handing them back. At this point in time, the final payment (if made) represents an acquisition of the goods and payment of the residual value is booked as an asset on the Balance Sheet.

Final Instalment

Account	Tax Code	Debit	Credit
Asset – Motor Vehicle	CAP	5 454.55	
GST Paid	N-T	545.45	
Cash At Bank	N-T		6,000.00

(Where CAP=Taxable Capital purchase; N-T=outside the scope of the GST system.)

You can therefore see, that under a lease arrangement, it is the regular monthly instalment that is expensed, and it is not until a decision is made at the expiry of the lease that any asset may be booked to the Balance Sheet. Note also that there is no liability booked to the Balance Sheet at any stage of the lease agreement.

Hire Purchase
A Hire Purchase arrangement is simply another form of finance. Its tax and GST treatment however are vastly different from both that of leasing and acquisition by chattel mortgage. As a result this form of finance needs to be considered on its own merits.

In essence, a hire purchase arrangement is an agreement to purchase goods by instalments. The term hire purchase is defined in S995-1 of the Income Tax Assessment Act 1997 (ITAA 1997) as:

" a contract for the hire of goods where:
i) the hirer has the right or obligation to buy the goods; and
ii) the charge that is or may be made for the hire, together with any other amount payable under the contract (including an amount to buy the goods or to exercise an option to do so), exceeds the price of the goods; and
iii) title in the goods does not pass to the hirer until the option to purchase is exercised; or
iv) where title in the goods does not pass until the final instalment is paid."

Unlike a lease where there is no obligation to acquire the goods at the end of the instalment period, a hire purchase arrangement provides for this obligation and as such the goods will be eventually owned by the purchaser.

As such, there is a real liability that is created when you enter into a hire purchase arrangement to eventually acquire the goods and as such this liability together with the asset acquired is recognised on the Balance Sheet.

Example 3

Assume that Michael from Example 1 finances the purchase under a Hire Purchase arrangement. Assume that the instalments are $415.00 per month for a period of 3 years and that the residual value at the end of this term is $6,000.

Accounting for the hire purchase transaction involves two steps.

The first step is to account for the acquisition of the asset (in this case a motor vehicle).

The journal entry to account for this is identical to the acquisition of the motor vehicle set out in example 1 "acquiring the asset outright" except rather than crediting the bank account for the purchase, the credit is to a Liability Account – Hire Purchase Motor Vehicle for the amount financed.

Account	Tax Code	Debit	Credit
Asset – Motor Vehicle	CAP	16 687.27	
GST Paid	N-T	1 668.73	
Asset – Motor Vehicle	N-T	398.00	
Asset – Roof Racks	CAP	310.00	
GST Paid	N-T	31.00	
Expense – M/V Registration	N-T	245.00	
Expense – M/V Insurance	GST	316.20	
GST Paid	N-T	31.62	
Expense – M/V Insurance	N-T*	42.18	
Liability – Hire Purchase M/V	N-T		19 730.00

(Where CAP=Taxable Capital purchase; GST=Taxable purchase; N-T=outside the scope of the GST system.) N-T = component of CTP Insurance outside the scope of GST.*

Please note that the amount financed could be for the full value of the asset purchased (in our case $19,730), or it could be for a lesser amount if Michael had contributed either cash or perhaps traded another vehicle into the deal. In our case we will assume that no cash or trade-in has been made and finance is taken out for the full value of the vehicle ($19,730).

For any Hire Purchase Agreement made after the 1/7/2012, both the purchase price of the vehicle and all interest charges and fees are subject to GST. This issue is discussed more later in this bulletin. The total interest component for the Hire Purchase is recorded:

Account	Tax Code	Debit	Credit
Liability – Hire Purchase M/V	N-T		xxx
Liability - HP unexpired interest	CAP	xxx	
GST Paid	N-T	xxx	
Liability - HP GST already claimed	N-T		xxx

(Where CAP=Taxable Capital purchase; N-T=outside the scope of the GST system.)

The second step is to then record the instalments paid each month in respect to the finance liability. In order to undertake this step you will need to acquire from the finance company or the client's accountant, a schedule that splits the payment each month into an interest component and a principal component. In our example, let's assume that the first payment of $415.00 resulted in an interest component of $97.07 (including GST, already claimed) and a principal component of $317.93. Once these components are identified, each Hire Purchase monthly payment can be dealt with as follows:

Account	Tax Code	Debit	Credit
Expense – Interest Hire Purchase	N-T	88.25	
Liability - HP GST already claimed	N-T	8.82	
Liability – Hire Purchase M/V	N-T	317.93	
Cash At Bank	N-T		415.00

(Where N-T=outside the scope of the GST system.)

It is important to note that only the GST exclusive amount of interest is income tax deductible. The GST amount on the total interest was claimed and reported on the BAS upfront and therefore the monthly payments are not reportable on the BAS. Also the interest and principal components are not the same each month. A common feature with all hire purchase agreements is that the interest is greater in the early term of the agreement and reduces as the agreement reaches maturity. This is why it is important to obtain the schedule identifying these components for the life of the hire purchase agreement.

In the case of a hire purchase agreement, the final instalment or residual value is simple treated as another instalment and unlike a lease does not need to be booked to an asset account on the balance sheet but rather, against the Hire Purchase Liability.

Chattel Mortgage

A chattel mortgage from the perspective of recording the asset purchase and recognising the liability is identical to that of a hire purchase arrangement. The difference between a Chattel Mortgage and other forms of finance such as hire purchase and lease comes when dealing with the GST consequences which will be discussed later in this bulletin.

A chattel mortgage as a form of finance treats the purchaser of the goods as the owner of the goods as if they had acquired them outright but have borrowed in order to do so. They are effectively treated as owning the goods from the outset of the arrangement unlike a hire purchase which views the purchaser as the eventual owner on payment of the final instalment.

Like the hire purchase arrangement, the repayment of borrowed funds is required to be broken down into an interest and principal component which is then expensed and reduces the borrowing similar to a hire purchase.

The entry to record the initial acquisition is similar to a hire purchase (refer example 3 above).

The entry to record the monthly repayment for a Chattel Mortgage is:

Account	Tax Code	Debit	Credit
Expense – Interest Chattel Mortgage	FRE	97.07	
Liability –Chattel Mortgage M/V	N-T	317.93	
Cash At Bank	N-T		415.00

(Where FRE=GST Free purchase; N-T=outside the scope of the GST system.)

INCOME TAX IMPACT AND GST CONNOTATIONS OF ACQUIRING A MOTOR VEHICLE

Having considered a number of the various options available for acquiring a motor vehicle, lets now consider the income tax and GST connotations of these options.

Income Tax Considerations

The income tax considerations are premised on the ownership consequences of the transaction. Obviously, outright purchase reflects ownership of the goods, but what about the financed options? We identified in our earlier discussion that the central issue that surrounds any form of financing and how it is to be accounted for, is whether the person providing the asset under the finance arrangement is the legal owner of that asset. In the eyes of the Tax Office, ownership of an asset will confer on the owner, rights to depreciate or decline the value of the goods under the capital allowance provisions. Where the goods are not owned but rather rented or hired, then the rental payments are treated as the cost incurred in using these goods.

Therefore, we can see from our earlier discussion, that Hire Purchase and Chattel Mortgage arrangements confer ownership on the purchaser of goods acquired under these forms of finance. Leasing arrangements however are treated as a rental arrangement until a decision is made at the end of the lease to either acquire the goods or hand them back. It is this point in time that an ownership decision is required of the hirer, but until that point the instalments paid are treated as rental payments with ownership being retained by the Lessor.

Where the motor vehicle is either purchased outright, or financed under a hire purchase or chattel mortgage arrangement, then an income tax deduction may be allowable in respect of the depreciation or decline in value of the motor vehicle acquired. The Tax Office have identified in their capital allowance tables that a motor vehicle has an effective life of 8 years and may decline in value at the rate of 12.5% if using the prime cost method or 25% if using the diminishing value method.

Previous editions of the Bookkeepers Knowledge Base have dealt in depth with Depreciation/Decline in Value so we will not discuss this issue further, save for the impact of the Motor Vehicle Depreciation Limit (see below).

The entry required to record the decline in value once calculated would be as follows:

Account	Tax Code	Debit	Credit
Depreciation expense (P&L account)	N-T	xxx	
Accumulated Depreciation (Bal sheet)	N-T		xxx

(Where N-T=outside the scope of the GST system.)

In addition to the decline in value that is afforded under the capital allowance provisions where the goods are owned or deemed to be owned by the purchaser, there are the financing costs to consider. Under both the Hire Purchase and Chattel Mortgage arrangements, the purchaser is faced with a regular instalment that is required to be split into an interest and a principal component. We identified that it is the interest costs that are to be expensed, whilst the principal costs reduce the financed amount in the balance sheet. It is therefore very important to obtain from either the bank or the client's accountant a schedule that identifies the split in these components for each repayment and to account for that split accordingly.

The journal entry to record this split was noted earlier.

Contrast the treatment of financing under a hire purchase or chattel mortgage with that of leasing a vehicle. Under a lease arrangement ownership vests with the lessor and it is the whole lease payment that is expensed in the profit and loss rather than being split into a principal and interest component.

The extent of the allowable deduction for income tax purposes will depend upon the business usage of the vehicle by the entity.

We do not propose to discuss in this article the various methods of determining the deductible amount for income tax purposes, but rather, the principle to be taken away is that you must look to the type of financing arrangement in place in order to determine its treatment in the accounts.

Ownership confers a claim for interest and depreciation, with the principal amount reducing the liability in the balance sheet. On the other hand renting, hiring or leasing of goods under an arrangement that does not confer ownership will result in the whole instalment being treated as an expense in the profit and loss account and no liability or corresponding asset booked in the balance sheet.

Borrowing Costs may also be associated with each of the forms of finance that we have discussed in this bulletin. Borrowing costs are distinct from the interest costs that may be associated with the repayments.

Typically, borrowing costs include legal costs, search fees, valuation fees, registration fees, commissions paid, or other expenses incurred in raising money. The accounting and income tax connotations of borrowing costs are as follows:

To account for any borrowing cost that may have been incurred as a result of acquiring a motor vehicle, you must first determine the amount of the total borrowing costs. Where this amount is less than $100 in total, it may be expensed to the profit and loss account. Where the amount exceeds $100 in total, the borrowing costs are written off over the period of 5 years or the term of the borrowing for which they were incurred (whichever is the shorter).

Where borrowing costs are to be written off over a period of time, the total costs are booked to an Intangible Asset account in the balance sheet and the amount to be written off each year is then expensed to the profit and loss, with a corresponding reduction in the Intangible Asset.

Example 4

Assume that Michael incurred borrowing costs in securing his loan for the vehicle at a cost of $300. Assume that Michael acquired the vehicle on 1 July. As the term of the loan for Michael is 3 years, and the total borrowing costs are > $100 Michael must write the borrowing costs off over this 3 year period.

His annual write-off will therefore be $100 ($300/3).

The journal entries to record these transactions would be as follows:

To record the borrowing expense paid upon procurement of the loan:

Account	Tax Code	Debit	Credit
Borrowing Cost Write Off (Intangible Asset -Bal Sheet)	GST	272.73	
GST Paid	N-T	27.27	
Cash at Bank	N-T		300.00

(Where GST=Taxable purchase; N-T=outside the scope of the GST system.)

To record the annual write-off of the borrowing expense:

Account	Tax Code	Debit	Credit
Borrowing Expenses (Profit and Loss)	N-T	100.00	
Borrowing Cost Write Off (Intangible Asset – Bal Sheet)	N-T		100.00

(Where N-T=outside the scope of the GST system).

GST Connotations

Outright Purchase (cash basis for GST)
Creditable acquisitions are attributable to the tax period in which the entity physically pays for the supply.

Example 5

Assume Michael purchased the new Barina for his business outright by paying a $200 deposit on 22 September 2016. On 15 October 2016, he takes delivery of the vehicle and pays a bank cheque on this date for the balance. Assume Michael is a quarterly BAS lodger.

Under a cash basis of accounting for GST, the $200 deposit would be returned as a capital acquisition on Michael's September 2016 BAS. The final payment on 15 October 2016 would be included in Michael's December 2016 BAS as a capital acquisition.

Outright Purchase (accruals basis for GST)
Under the accruals basis, creditable acquisitions are attributable to the tax period in which the earlier of the following occurs:

- an invoice is issued/received; or
- the consideration is received/paid.

Example 6

Assume the same set of facts as per example 5 except that Michael operates under an accruals basis for accounting for GST. On payment of the deposit, Michael received a Tax Invoice for the Barina.

Michael would therefore record in capital acquisitions, the full value of the purchase of the Motor Vehicle on the September 2016 BAS.

Hire Purchase contracts (cash or accruals basis for GST)

Purchase of asset: Since the 1/7/2012 you are entitled to the **full amount of the GST immediately on the purchase price of the vehicle and all interest charges and fees**, irrespective of whether you account on a cash or accrual basis for GST. You should therefore record the asset as a capital acquisition. Bear in mind also that if an amount has been shown as a capital acquisition, you may still be required to add back an amount relating to input taxed usage or private usage if applicable.

Payment of instalments: For BAS purposes; since the 1/7/2012 all the input tax credit is claimed upfront, therefore the principal component and interest component of each Hire Purchase instalment is to be treated as being outside the GST system.

Chattel Mortgage (cash basis or accrual basis for GST)

Purchase of asset: Under a chattel mortgage arrangement, you are entitled to the **full amount of the GST on the purchase price of the vehicle immediately,** irrespective of whether you account on a cash or accrual basis for GST. This is because the creation of the Chattel Mortgage contract amounts to a settlement for the purchase of the vehicle. You should therefore record the asset as a capital acquisition. Bear in mind also that if an amount has been shown as a capital acquisition, you may still be required to add back an amount relating to input taxed usage or private usage if applicable.

Payment of instalments: The interest component of each Chattel Mortgage instalment is a financial supply, therefore needs to be treated as a GST Free acquisition. The principal component of each instalment is to be treated as being outside the GST system.

Leasing (cash or accrual basis)
As we identified in our earlier discussion, leased goods are not owned by the lessee, but rather, ownership is retained by the lessor. As such there is no purchase of an asset but rather there are rental or hire payments in respect of the assets use. It is the rental payments themselves that attract any GST.

As such any GST to be claimed is done so in respect to the amount that may be embedded in the lease instalment. For a taxpayer accounting on the cash basis, any GST would be claimed in the period the physical lease payment was made. For an accruals basis GST taxpayer the GST would be claimed in the tax period in which the lease payment was due (whether paid or not).

Also note that in respect to lease payments, any GST claimed is not considered a capital acquisition and would be included with normal acquisitions of the business.

IMPACT OF THE MOTOR VEHICLE DEPRECIATION LIMIT

Thus far in our bulletin, we have considered the ramifications of purchasing or financing a vehicle under a number of different methods and the income tax and GST implications of these different methods as they relate to motor vehicles.

We now pose the question: Does the cost of the vehicle play a part in the income tax and GST treatments of the different methods of financing?

Basically, the answer is YES on both counts!

Income Tax Impact

Section 40-230 ITAA 1997 imposes a maximum limit on the cost of a car for the purposes of determining its decline in value. For the 2017/2018 financial year this limit is $57 581 and is indexed from time to time. What this means is that when a taxpayer first holds a motor vehicle, any future decline in value is determined by reference to the motor vehicle depreciation limit in the year that the vehicle was acquired.

Example 7

In the 2017/2018 financial year, Peter acquired a new Mercedes at a cost of $97,000. The motor vehicle depreciation limit in 2017/2018 was $57 581. Therefore the maximum GST claimable is $5 235 (1/11th of $57 581).

The motor vehicle depreciation limit applies to cars mainly designed to carry passengers and applies whether the vehicle is new or second hand.

Vehicles excluded from the depreciation limit include:

- Motorcycles;
- Vehicles designed to carry a load of more than one tonne;
- Vehicles designed to carry more than 9 passengers; and
- Vehicles that are fitted out for transporting disabled people in wheelchairs for profit or modified to enable a person with a disability to use the vehicle for a taxable purpose.

In addition, before applying the motor vehicle depreciation limit, any discounts applied as a result of a trade-in and input tax credits to which the taxpayer may be entitled are adjusted for. Note there are anti-avoidance rules in place to prevent taxpayers from getting around the cost limit rules by offering a reduction in the price of a traded vehicle in exchange for a lowering of the price on the newly acquired vehicle.

Example 8

Peter is looking to purchase a vehicle at a cost of $62 000. He currently owns a vehicle with a market value of $30 000. Peter offers to trade his existing vehicle at a price of $20 000 for a lowering in the price of the new vehicle to $52 000. Whilst the changeover figure remains the same ($32 000), Peter believes his new vehicle does not breach the depreciation limit. The anti-avoidance provisions would operate however to gross Peter’s vehicle up to its cost of $62 000 (above the 2017/2018 limit of $57 581)

The bookkeeping impact of the motor vehicle depreciation limit on vehicles purchased outright or under a finance arrangement, that has the purchaser as the “owner” of the vehicle (including hire purchase or chattel mortgage) is as follows:

1. The full cost price of the vehicle is booked to the Motor Vehicle Asset Code in the balance sheet with the corresponding credit either being cash at bank if purchased outright or a liability account representing the loan if the vehicle was financed.

2. The decline in value amount is calculated with reference to the motor vehicle depreciation limit for the year of purchase.

3. There is no impact upon the interest calculations or claim and principal reduction of the hire purchase or chattel mortgage. I.e. Where a luxury vehicle has been financed by way of hire purchase or chattel mortgage, the loan amortisation schedule to calculate the split between principal and interest does not alter as a result of the motor vehicle depreciation limit.

What about a leased vehicle?
A leased vehicle (either new or second hand) is treated as a luxury vehicle if its cost exceeds the motor vehicle depreciation limit in the financial year in which the lease was granted.

Rather than being treated as a lease (as explained above), the lease of a luxury vehicle is deemed to be an asset of the lessee and the amount financed taken to be a loan from the lessor.

Treated this way, the lessee is entitled to a claim for decline in value, the same as if the vehicle had been purchased outright or via one of the other financing methods. Similarly, the actual lease payments are divided into a notional principal and interest charge and afforded the same treatment as if the vehicle was financed under either a chattel mortgage or hire purchase arrangement.

These measures were introduced to overcome the use of a luxury car lease to circumvent the motor vehicle depreciation limit rules.

From a bookkeeping perspective:

1. Even though the finance document might identify that the transaction is a lease, book the luxury vehicle as an asset;

2. Calculate an amount for decline in value as if the transaction were one of a hire purchase or chattel mortgage;

3. Calculate or request a calculation for the notional split in lease payments between principal and interest and treat the payment the same as if it were a hire purchase or chattel mortgage instalment.

GST Impact
The issue that surrounds the purchase of a luxury vehicle as it relates to GST is whether or not the taxpayer is entitled to a full input tax credit for the GST paid on purchase having regard to the motor vehicle depreciation limit.

In short, the answer is NO. An entity acquiring a motor vehicle that exceeds the motor vehicle depreciation limit, is limited in claiming an input tax credit equal to $1/11^{th}$ of that limit. Therefore, as the motor vehicle cost limit in 2017/2018 is $57 581, the maximum input tax credit you may claim is $5 235.

Any surplus credit that is not capable of being claimed is added to the cost base of the vehicle, which will then have an impact when the vehicle is disposed.

If a business is not entitled to a full input tax credit as a result of a reduction in creditable use, the calculation is based on an input tax credit with reference to the motor vehicle depreciation limit.

Example 9

Peter purchases a luxury vehicle on 2 September 2017. Peter only uses the vehicle 50% for the carrying on of his business activities. Peter is entitled to an input tax credit of $2 617.50 (50% x $5 235).

There are, however, some instances when a full input tax credit is entitled to be claimed regardless of the cost limit. These include when:

- The car is held as trading stock
- The car is to be exported
- The vehicle is an emergency vehicle
- The vehicle is a commercial vehicle not designed for the principal purpose of carrying passengers, or
- The vehicle is specifically fitted out for transporting disabled people seated in wheelchairs.

The GST impact on the various forms of ownership/financing (purchased outright, chattel mortgage or hire purchase) would be as follows:

Outright Purchase or Chattel Mortgage
In our earlier discussion, we identified that acquisition of a car under these methods results in an immediate claim for the GST credits.

Whether cash or accrual, the input tax credit will be limited to $1/11^{th}$ of the motor vehicle depreciation limit subject to creditable purpose usage and the normal attribution rules. The excess sum of the input tax credit would not feature on the BAS at all and would be denoted as being outside the GST system (tax code N-T).

Hire Purchase
Since the 1/7/2012 under an accrual and cash method of accounting for a hire purchase, the GST is entitled to be claimed immediately. Therefore, the input tax credit will be limited to $1/11^{th}$ of the motor vehicle depreciation limit subject to creditable purpose usage.

The amount GST exceeding the cost limit sum should not feature in the BAS at all, and would be denoted as being outside the GST system (tax code N-T).

What if a luxury car is leased, can a claim be made for all the GST included in the lease payments?

As strange as it may sound, the answer is yes! Even though a luxury lease is effectively treated as a loan and an asset booked limiting the value of the car to the motor vehicle depreciation limit. As there is no GST embedded in the cost of a leased vehicle, the lease payments themselves house the GST. As such, all the input tax credits included in the payment of a lease on a luxury vehicle may be claimed as an input tax credit or apportioned appropriately, as the case may be, if the vehicle does not attract 100% creditable usage.
