Lesson Objectives
- To understand the Concept of Hire Purchase Finance,
- Regulations related to Hire purchase.

Introduction
Hire purchase, as a form of financing, differs from lease financing in one basic respect: while in hire purchase transaction, the hirer has the option to purchase the asset at the end of the period on payment of the last installment of hire charge, the lessee does not have the option to acquire the ownership of the leased asset. A hire purchase transaction has, therefore, some typical features from the point of view of accounting and reporting.

First, although the legal title over the equipment remains with the hire vendor (financer), all risks and rewards associated with the asset stand transferred to the hirer at the inception of the transaction. The accounting implication is that the asset should be recorded in the books of the hirer. The hire-vendor should record them as hire asset stock in trade or as receivables.

Secondly, the hire charges, like the lease rental in a financial lease, have two components (a) interest charges (b) recovery of principal.

In India, we do not have any accounting guidelines or standards for accounting treatment of hire purchase. There is also no specific law / regulation to govern hire purchase contracts. The aspects which have a bearing on the accounting and reporting of hire purchase deals are the timings of the capitalization of the asset (inception v/s conclusion of the deal), the price, the depreciation charge and the treatment of hire charges.

Now, let us discuss the accounting and reporting treatment of transactions in the books of hirer and financer.

Accounting Treatment in the Books of Hirer
The cash purchase price of the asset is capitalized and the capital content of the hire purchase installment, that is, the cash purchase price less down payment, if any, is recorded as a liability. The depreciation is based on the cash purchase price of the asset in conformity with the policy regarding similar owned assets. The total charges for credit (unmatured finance charge at the inception of the hire purchase transaction) is allocated over the hire period using one of the several alternative methods, namely, effective rate of interest method, sum of years digits method and straight line method.

Accounting Treatment in the Books of Hire-vendor (Finance Company)
At the inception of the transaction, the finance company should record the hire purchase installments receivables as current asset (i.e. stock on hire) and the unearned finance income component of these installments as a current liability under the head unmatched finance charges. At the end of each accounting period, an appropriate part of the unmatured finance income should be recognized as current income for the period. It would be allocated over the relevant accounting periods on the basis of any of the following methods (a) ERI (b) SOYD and (c) SLM. At the end of each accounting period, the hire purchase price less the installments received should be shown as receivable / stock on hire and the finance income component of these installment should be shown as current liability / unmatched finance charge. The direct costs associated with structuring the transactions / deal should be either expensed immediately or allocated against the finance income over the hire period.

Financial Evaluation
Now let us discuss the framework of financial evaluation of a hire purchase deal vis-à-vis a finance lease from both the hirer's as well as the finance company's viewpoint.

From the Point of View of the Hirer (Purchaser):
The tax treatment given to hire purchase is exactly the opposite of that given to lease financing. It may be recalled that in lease financing, the lessee is entitled to claim depreciation and other deductions associated with the ownership of the equipment including interest on the amount borrowed to purchase the asset, while the lessee enjoys full deduction of lease rentals. In sharp contrast, in a hire purchase deal, the hirer is entitled to claim depreciation and the deduction for the finance charge (interest) component of the hire installment. Thus, hire purchase and lease financing represent alternative modes of acquisition of assets. The evaluation of hire purchase transaction from the hirer's angle, therefore, has to be done in relation to leasing alternative.

Decision criterion: The decision criterion from the point of view of hirer is the cost of hire purchase vis-à-vis the cost of leasing. If the cost of hire purchase is less than the cost of leasing, the hirer should prefer the hire purchase alternative and vice-versa.

Cost of hire purchase: The cost of hire purchase to the hirer consists of the following:
1. Down payment
2. + Service Charges
3. + Present value of hire purchase payments discounted by the cost of debt.
4. – Present value of depreciation tax shield discounted by cost of capital.
5. – Present value of net salvage value discounted by cost of capital.

Cost of leasing: The cost of leasing consists of the following elements:
1. Lease management fee
2. + PV of lease payments discounted by cost of debt.
3. What are the kinds of assets purchased under a hire purchase agreement?

Movable assets like cars, machinery, fixtures and furniture, computers and electronic items, that can be delivered physically, can be purchased. Immovable property cannot be purchased under a hire purchase agreement. The transaction with reference to immovable property is normally referred to as sale and lease agreement.

4. Is a guarantor required in a hire purchase agreement and if so who can be a guarantor?

A guarantor is not essential for a hire purchase transaction, unless the financier insists on it. Most financiers however insist on a guarantor. The guarantor acts as an additional security against default in payment by the hirer. Any creditworthy person can be a guarantor, if the financier is satisfied that he can repay the money in case of default by the hirer.

5. What is the financier’s security in a hire purchase agreement, without a guarantor?

The financier may ask the hirer for an immovable property as security. However the primary security for the financier is the product purchased under the agreement.

6. What precautions should a hirer take before he enters into a hire purchase agreement?

- Before entering into a hire-purchase agreement, a person should 1.Sign on a hire purchase agreement form containing the terms of hire purchase. 2. Insist for a copy of the agreement for his record. 3. Keep a record of all payments made to the financier till the payment of the last installment. 4. Get a ‘no dues’ receipt from the financier after full payment of the hire purchase charges.

7. Can I pre-pay all my installments under hire purchase agreement?

- Normally a financier does not allow any pre-payment of installments unless he is compensated for the loss of interest.

8. Will default or delay in the payment of installments attract penalty?

- Yes. Usually, the hirer has to pay a penalty or fine to the financier for default or delay in the payment of the dues under the agreement.

9. What are the income tax implications in the case of a hire purchase?

- In the hire purchase the hirer carrying business or profession gets benefit of depreciation. He can also claim deduction on the interest paid on hire charges, in his income tax assessment.

Hire Purchase: Taking the Customer to Court

Under modern hire purchase agreements, the hirers are simply paying for the use of the goods and for the option to buy them. Though hire purchase agreements are very common while buying consumer goods, there is no specific law that caters to the needs of the modern times. Parliament passed the Hire Purchase Act in 1972, but it is a classic case of neglect.
It has not been notified in the official gazette in three decades. Therefore it has no force of law. As a result, hire purchase agreements are covered by the law of contract and the interpretation given by the courts to the agreements.

Many of those who rush to buy motor vehicles and other goods realise the rigours of the contract only when the repossessors arrive. But then it is too late, as the Supreme Court judgement last week in Charanjit Singh vs Sudhir Mehra showed. Even in law, it is a lost battle for the buyer.

In this case, Sudhir bought a motor vehicle under a hire purchase agreement with a non-banking financial institution. When the instalment stopped, the financier forcibly took away the vehicle from the motor mechanic where it was given for repairs.

The purchaser filed a criminal complaint against the financier for theft, cheating and criminal breach of trust. The financier moved the Punjab high court for quashing the complaint. The high court dismissed it. So it moved the Supreme Court which quashed the complaint after finding fault with the high court view.

The problem arises because most of those who go in for hire purchase agreements do not understand the nature of the contract. The deed is also deliberately made bulky by the financier so that an ordinary buyer would not take time to read the terms.

Even if they try to read it, the legalese would put off even the educated. If you ask for your copy of the agreement after signing on the dotted lines till your fingers ache, there would be evasive answers. Thus it is a losing battle from the start.

The dealer would deliver the goods to the buyer and then drop out of the transaction, leaving the finance company to collect the instalments directly from the customer.

Under modern hire purchase agreements, the hirers are simply paying for the use of the goods and for the option to buy them. The finance charge, representing the difference between the cash price and the hire purchase price, is not interest but represents a sum which the hirer has to pay for the privilege of being allowed to discharge the purchase price of goods in instalments.

In this case, the small print gave the financier the right to “enter any building, premises or place where the vehicle may be kept for inspection, re-possession or attempt to re-possess”.

It further emphasised that such attempts will not make the financier liable for any civil or criminal action at the instance of the hirer. Therefore, even if a case is filed against the financier for dacoity in such circumstances (as in Sardar Trilok Singh vs Satya Deo, 1979), the financier will have the upper hand. The Supreme Court, in Damodar Valley Corporation v/s State of Bihar has discussed different types of agreements in the nature of hire purchase. These and other judgements make tedious reading.

What is required now is a comprehensive legislation taking into consideration the needs of the consumerist era. The law-makers who have neglected to notify the 1972 Act must now start working on a new legislation on the subject.