



# UNIT III HIRE PURCHASE

# HIRE PURCHASE

# INTRODUCTION

- Hire purchase is a **mode of financing** the price of an asset to be sold on a future date.
- It is a peculiar kind of transaction in which the goods are let on hire with an option to the hirer to purchase them.
- A Hire Purchase Agreement is an agreement between the seller and the buyer, where the *ownership of goods does not* pass to the buyer until he pays the last installment.
- There are two parties to the hire purchase agreement. The *hire vendor, who is the seller* and other, is the *hire purchaser, the buyer*.
- The purchaser has to make a down payment of **20 to 25%** of the cost and the remaining amount has to be paid in equal monthly installments.

- Small scale firms may find it difficult to acquire industrial machinery, office equipment, vehicles, etc., by making full payment through hire purchase.
- With the help of assets acquired through hire purchase they can produce and sell.
- Payments can easily be made in installments from the earning.
- Finally the ownership of assets can also be acquired.

# Definition:

According to the ***Hire Purchase Act of 1972***, the term hire purchase is defined as, an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement, and includes an agreement under which

- a. Possession of goods is delivered by the owner thereof to a person on the condition that such person pays the agreed amount in periodic payments
- b. The property of the goods is to pass to such a person on the payment of the last of such installment
- c. Such a person has a right to terminate the agreement any time before the companies are controlled by the Hire Purchase Act, 1972.

A Hire purchase transaction has two elements, **Bailment** which is governed by the **Indian Contract Act, 1872** and **Sale** under the **Sale of Goods Act, 1930**.

# FEATURES

- The buyer takes *possession of goods immediately* and agrees to pay *the total hire purchase price in installments*.
- Each installment is treated as *hire charges*.
- The ownership of the goods passes from the seller to the buyer on the payment of the last installment.
- In case the buyer makes any default in the payment of any installment the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charges.
- The hirer has the right to terminate the agreement any time before the property passes. That is, he has the option to return the goods in which case he need not pay installments falling due thereafter.
- However, he cannot recover the sums already paid as such sums legally represent hire charges on the goods in question.

# INDIAN SCENARIO

- The British concept of hire-purchase has, been there in India for more than 6 decades.
- The first hire-purchase company is believed to be ***Commercial Credit Corporation***, successor to Auto Supply Company.
- While this company was based in Madras, Motor and General Finance and Installment Supply Company were set up in North India.
- These companies were set up in the 1920s and 1930s.
- Development of Hire-purchase took two forms: ***consumer durables and automobiles.***

# Law Governing the hire-purchase contract, agreement, & transactions

- In the absence of specific law, the hire-purchase transactions are governed by the provisions of the Indian Contract Act & the Sales of Goods Act.
- The hire-purchase agreement has two aspects:
- An aspect of bailment of the goods which is covered by the Contract Act, and other one is sale when the option to purchase is exercised by the hirer which is covered by Sales of Goods Act.



# Advantages of Hire Purchase System:

## **(1) Convenience in Payment:**

- The buyer is greatly benefited as he has to make the payment in installments. This system is greatly advantageous to the people having limited income.

## **(2) Increased Volume Of Sales:**

- This system attracts more customers as the payment is to be made in easy installments. This leads to increased volume of sales.

## **(3) Increased Profits:**

- Large volume of sales ensures increased profits to the seller.

#### **(4) Encourages Savings:**

- It encourages thrift among the buyers who are forced to save some portion of their income for the payment of the installments. This inculcates the habit to save among the people.

#### **(5) Helpful For Small Traders:**

- This system is a blessing for the small manufacturers and traders. They can purchase machinery and other equipment on installment basis and in turn sell to the buyer charging full price.

## **(6) Earning Of Interest:**

- The seller gets the installment which includes original price and interest. The interest is calculated in advance and added in total installments to be paid by the buyer.

## **(7) Lesser Risk:**

- From the point of view of seller this system is greatly beneficial as he knows that if the buyer fails to pay one installment, he can get the article back.

- Immediate use of assets without paying the entire amount.
- Expensive assets can be utilized as the payment is spread over a period of time.
- Fixed rental payments make budgeting easier as all the expenditures are known in advance.
- Easy accessibility as it is a secured financing.
- No need to worry about the asset depreciating quickly in value as there is no obligation to buy the asset.

# DISADVANTAGES OF HIRE PURCHASE

- Total amount paid towards the asset could be much higher than the cost of the asset due to substantially high-interest rates.
- The long duration of the rental payments.
- Ownership only at the end of the agreement. The hirer cannot modify the asset till then.
- The addition of any covenants increases the cost.
- If the hired asset is no longer needed because of any change in the business strategy, there may be a resulting penalty.

# Hire Purchase and Credit Sale

- Higher purchase transaction is different from credit sale.
- In case of actual sale, the title in the property i.e, ***ownership and possession is transferred to the purchaser simultaneously,***
- In hire purchase the ownership remains with the seller until last installment is paid.

# Difference between Hire Purchase and Installment System –

## ***(1) Nature of Contract***

Hire Purchase System: It is a hiring goods agreement. System of buying goods by making regular payments until the full price is paid.

Installment System: It is an agreement of sale. System of credit sale in which a sum of money or debt is paid regularly in installment.

## ***(2) Ownership***

Hire Purchase System: Ownership of goods is transferred after the payment of the final installment. Ownership of goods remains with the seller until the full price is paid

Installment System: Ownership of the goods passes to the buyer just signing the agreement. Ownership is transferred immediately after the first installment

## ***(3) Right***

Hire Purchase System: The buyer can not sell, destroy or transfer the goods.

Installment System: The buyer can sell, destroy or mortgage or transfer as his/her wish.

#### ***(4) Risk***

Hire Purchase System: All the risks are borne by the vendor before the payment of the final installment.

Installment System: All the risks are to be borne by the buyer from the date of the agreement.

#### ***(5) Right of Return***

Hire Purchase System: The buyer can return the goods before making the final installment. Goods can be returned to the seller before the final installment.

Installment System: The buyer can not return the goods to the seller.

#### ***(6) Repair and Maintenance***

Hire Purchase System: The liability of repair and maintenance lies with the seller-provided that the buyer takes the utmost good care.



# Hire Purchase and Leasing

Hire Purchase is also different from leasing on following grounds:

## 1. Ownership

In a contract of lease, the ownership rests with the lessor throughout and the lessee (hirer) has no option to purchase the goods.

## 2. Method of Financing

Leasing is a method of financing *business assets* whereas hire purchase is a method of financing both *business assets and consumers articles*.

## 3. Depreciation

- In leasing depreciation and investment allowance cannot be claimed by the lessee.
- In hire purchase, depreciation and investment allowance can be claimed by the hirer.

## **4. Tax Benefits**

- The entire lease rental is tax deductible expense. Only the interest component of the hire purchase installment is tax deductible.

## **5. Salvage Value**

- The lessee, not being the owner of the asset, does not enjoy the salvage value of the asset.
- The hirer, in purchase, being the owner of the asset, enjoys salvage value of the asset.

## **6. Deposit**

- Lessee is not required to make any deposit whereas 20% deposit is required in hire purchase.

## 7. Rent-Purchase

- With lease, **we rent** and with hire purchase **we buy** the goods.

## 8. Extent of Finance

- Lease Financing is invariably **100** per cent financing.
- It requires no immediate down payment or margin money by the lessee.
- In hire purchase, a margin equal to **20-25 per cent** of the cost of the asset is to be paid by the hirer.

## 9. Maintenance

- The cost of maintenance of the hired asset is to be borne by the hirer himself.
- In case of finance lease only, the maintenance of leased asset is the responsibility of the lessee.

## 10. Reporting

- The asset on hire purchase is shown in the balance sheet of the hirer. The leased assets are shown by way of foot note only.

<b>Characteristics</b>	<b>Leasing</b>	<b>Hire purchasing</b>
ownership	With the finance company, the lessor	It is transferred to the hirer on the payment of the last installment
Depreciation	Lessor, and not the lessee is entitled to claim depreciation tax shield	The hirer is entitled to claim depreciation tax shield
Capitalization	Done in the books of lessor	Done in the books of hirer
Payments	The entire lease payments are eligible for tax computation in the books of lessee	Only the hire interest is eligible for tax computation in the books of hirer
Magnitude	Used as a source of finance, usually for acquiring high cost assets such as machinery, ships etc	Used as a source of finance, usually for acquiring low cost assets such as automobiles, office equipments etc
Maintenance of asset	Lessee in case of financial, Upkeep is the responsibility of the lessor in the case of operating lease	It is the hirer's responsibility to ensure the maintenance of the asset bought
Nature of asset	Asset- as a fixed asset of the lessor	Shows the asset either as a stock in trade or as receivables
Down payment	No down payment required	It is required