



Fact Sheet – Novated Leases

What is Novated Lease?

A novated lease refers to an arrangement whereby all or part of the lessee's rights or obligations under the vehicle lease are taken over by an employer. The lessee is usually the employee but could be an associate of the employee such as a spouse and in that case the employer would assume the associate's rights/obligations under the lease.

On payment of the last lease payment or on termination of employment a further novation may occur. The deed of novation usually contains a clause which has the effect that on the earlier of the termination of the lease or cessation of employment, the employer's obligations are novated to the employee who again becomes the lessee. If the employee has ceased employment this enables the employee to enter into a new novated lease arrangement with another employer.

There are two main types of novated leases:

1. a full or "split full" novation that involves a revocation of the original lease; and
2. a partial novation which does not revoke the original lease

Because of the adverse approach taken by the ATO in relation to partial novations they are not as widely encountered as full novations.

What's the benefit to the employer?

Novated leases grew out of a demand from employers who did not want the responsibility and costs associated with dealing with motor vehicles at the end of an employee's period of employment.

Other attractions of novated leases is that the employer would generally be entitled to a full deduction for the lease payments while the lease liability would not appear on the balance sheet. There could also be a saving on employee "on costs".

What's the benefit to the employee?

The main benefit is that the lease can be "packaged" and treated under the FBT rules which can have benefits depending on the use that is made of the car.

Other attractions from an employee's perspective are:

- The lease is effectively transportable if there is a change of employer (although the employer has to be prepared to be involved in such arrangements)
- An offer can be made at the end of the lease
- The vehicle can be used by the family which may not always be possible with a standard company car.

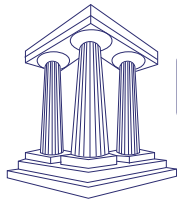
Why not use a Novated Lease?

Novated leases are very popular however I do not believe they are all they are cracked up to be for the following reasons:

1. **Borrowing.** They involve borrowing to purchase a depreciating asset. The only circumstance where I can justify borrowing is for an asset that has the potential to increase in value.
2. **New car depreciation.** Although you can purchase a second hand vehicles using a novated lease the majority of leases are for new cars. New vehicles drop over 40% in value in the first two years. Additionally, employees tend to go out and upgrade to the latest vehicle at the end of the lease so they don't receive the advantage of driving a fully paid for vehicle.
3. **Statutory method for calculating Fringe Benefits Tax / Kilometres.** Under this method of calculating the fringe benefits tax associated with the lease the more kilometres you travel in the vehicle the less tax you pay. This encourages illogical behaviour i.e. encourages us to drive more kilometres each year. This is both bad for the environment (using more petrol, oil and tires) but the additional kilometres will depreciate the value of your car more quickly.
4. **Decreasing marginal tax rates.** As tax rates have decreased over the last couple of years and will continue to do so over the next couple of years the advantages of salary packaging and negative gearing diminish.

What's the alternative?

Buy a good quality late model second hand vehicle for cash and drive it for as long as possible (or as long as your ego can handle). You'll not only benefit from someone else bearing the 40% depreciation in the first two years but also avoid the less than healthy new car smell.



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