

Hire Purchase System

Hire Purchase System

Meaning of Hire Purchase System:

- In a hire purchase system, goods are delivered to the purchaser immediately upon signing the agreement.
- The purchaser, referred to as the 'Hire Purchaser', pays the purchase price in periodic installments.
- These installments can be monthly, quarterly, half-yearly, or yearly, depending on the agreement.
- Each installment is considered a hire charge until the final installment is paid.
- Once the final payment is made, ownership of the goods transfers from the seller (the 'Hire Vendor') to the buyer.
- If the buyer defaults on even the last installment, the seller can repossess the goods and keep the payments made as hire charges.

Characteristics or Legal Provisions of Hire-Purchase System:

Right to Use the Goods:

Upon signing the agreement, the hire-purchaser receives possession of the goods and is entitled to use them.

Payment in Installments:

- According to Section 3 of the relevant Act, the hire purchase agreement must be in writing and signed by the involved parties.
- The agreement must specify:
  - The hire purchase price of the goods
  - The cash price of the goods
  - The date of commencement of the agreement
  - The number and amount of installments

Ownership of Goods:

Possession of goods is delivered to the hire purchaser at the signing of the agreement, but ownership does not transfer until the final installment is paid.

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**Right of the Hirer to Purchase with Rebate:**

The hire purchaser has the right to purchase the goods by giving a 14-day notice to the owner.

**Instalment Payment System**

**Meaning of Instalment Payment System:**

In this system, both ownership and possession of the goods transfer to the buyer immediately when the contract is signed, even though the purchase price is paid in installments. If the buyer defaults on any installment, the seller cannot repossess the goods; the seller's only recourse is to sue the buyer for the unpaid balance.

**Characteristics of the Instalment Payment System:**

**Contract of Sale:**

It is a credit sale agreement, where the goods are sold on credit, with payment to be made in installments.

**Transfer of Ownership:**

Ownership of the goods transfers from the seller to the buyer as soon as the contract is signed, regardless of whether all installments have been paid.

**Default in Payment of Installments:**

If the buyer defaults on an installment, the seller cannot repossess the goods. The seller's only option is to sue for the unpaid balance and any applicable interest.

**Key Differences Between Hire Purchase System and Instalment Payment System:**

**Transfer of Ownership:**

- In a hire purchase system, ownership transfers after the final installment is paid.
- In an installment payment system, ownership transfers immediately when the contract is signed.

**Repossession of Goods:**

- In a hire purchase system, the seller can repossess the goods if the buyer defaults on payment.

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- In an installment payment system, the seller cannot repossess the goods; they can only sue for the unpaid balance.

**Nature of Agreement:**

- Hire purchase is essentially a lease agreement until the final payment is made.
- The installment payment system is a credit sale agreement where the buyer becomes the owner immediately.

**Solved Example: Hire Purchase System - Interest Calculation when Interest is included in Installments**

**Ques:** A company purchases a machine on hire purchase on January 1, 2024. The cash price of the machine is Rs. 1,00,000. The terms of the agreement are that Rs. 20,000 is to be paid on delivery (i.e., on January 1, 2024) and the balance in four equal annual installments of Rs. 22,000 each, starting from December 31, 2024. The rate of interest is 10% per annum.

Calculate the interest and principal component of each installment.

**Solution:**

Determine the total installments amount:

Initial payment = Rs. 20,000

Annual installment = Rs. 22,000

Number of installments = 4

Total installments amount = Rs. 20,000 + 4 \* Rs. 22,000 = Rs. 1,08,000

**Interest Calculation:**

The outstanding balance before each installment can be calculated as follows:

Outstanding balance after initial payment = Cash price - Initial payment

= Rs. 1,00,000 - Rs. 20,000

= Rs. 80,000

Interest for the first year (2024) = Outstanding balance \* interest rate

= Rs. 80,000 \* 10%

= Rs. 8,000

Principal repayment in the first installment = Annual installment - Interest

= Rs. 22,000 - Rs. 8,000

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= Rs. 14,000

Outstanding balance after first installment = Outstanding balance - Principal repayment  
= Rs. 80,000 - Rs. 14,000  
= Rs. 66,000

Following the same procedure, calculate the interest and principal for the remaining installments:

**Second installment:**

Interest = Rs. 66,000 \* 10% = Rs. 6,600  
Principal repayment = Rs. 22,000 - Rs. 6,600 = Rs. 15,400  
Outstanding balance after second installment = Rs. 66,000 - Rs. 15,400 = Rs. 50,600

**Third installment:**

Interest = Rs. 50,600 \* 10% = Rs. 5,060  
Principal repayment = Rs. 22,000 - Rs. 5,060 = Rs. 16,940  
Outstanding balance after third installment = Rs. 50,600 - Rs. 16,940 = Rs. 33,660

**Fourth installment:**

Interest = Rs. 33,660 \* 10% = Rs. 3,366  
Principal repayment = Rs. 22,000 - Rs. 3,366 = Rs. 18,634  
Outstanding balance after fourth installment = Rs. 33,660 - Rs. 18,634 = Rs. 15,026

However, note that the outstanding balance should be zero after all installments. Therefore, adjustments might be needed for the final installment.

In this case, the fourth installment's principal will exactly settle the balance.

**Summary of Installments:**

**First installment:**

Interest: Rs. 8,000  
Principal: Rs. 14,000

**Second installment:**

Interest: Rs. 6,600  
Principal: Rs. 15,400

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Third installment:  
Interest: Rs. 5,060  
Principal: Rs. 16,940

Fourth installment:  
Interest: Rs. 3,366  
Principal: Rs. 18,634

Assignment

Ques 1: A furniture store sells a dining table set on hire purchase on January 1, 2024. The cash price of the dining table set is Rs. 50,000. The terms of the agreement are that Rs. 10,000 is to be paid on delivery, and the balance is to be paid in three equal annual installments of Rs. 15,000 each, starting from December 31, 2024. The rate of interest is 8% per annum. Calculate the interest and principal component of each installment.

Ques 2: An electronics retailer sells a television on hire purchase on February 1, 2024. The cash price of the television is Rs. 30,000. The terms of the agreement are that Rs. 5,000 is to be paid on delivery, and the balance is to be paid in five equal annual installments of Rs. 6,000 each, starting from January 31, 2025. The rate of interest is 12% per annum. Calculate the interest and principal component of each installment.

Ques 3: A company purchases a computer system on hire purchase on March 1, 2024. The cash price of the computer system is Rs. 75,000. The terms of the agreement are that Rs. 15,000 is to be paid on delivery, and the balance is to be paid in four equal annual installments of Rs. 18,000 each, starting from February 28, 2025. The rate of interest is 10% per annum. Calculate the interest and principal component of each installment.

Ques 4: A small business buys a delivery van on hire purchase on April 1, 2024. The cash price of the van is Rs. 2,00,000. The terms of the agreement are that Rs. 40,000 is to be paid on delivery, and the balance is to be paid in five equal annual installments of Rs. 40,000 each, starting from March 31, 2025. The rate of interest is 9% per annum. Calculate the interest and principal component of each installment.

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**Solved Example: Hire Purchase System - Interest Calculation when Interest is not included in Installments**

**Question:** XYZ Ltd. purchases machinery costing Rs. 1,00,000 on hire purchase basis. The terms of the agreement are:

Down payment: Rs. 20,000  
Four annual installments of Rs. 25,000 each  
Interest is charged at 10% per annum on the outstanding balance

**Solution:**

**Calculate the total interest:**

Interest is calculated on the outstanding balance at the beginning of each year before the installment is paid.

**Prepare the calculation schedule:**

Year	Outstanding Balance (beginning)	Interest (10%)	Installment	Outstanding Balance (end)
1	Rs. 80,000	Rs. 8,000	Rs. 25,000	Rs. 63,000
2	Rs. 63,000	Rs. 6,300	Rs. 25,000	Rs. 44,300
3	Rs. 44,300	Rs. 4,430	Rs. 25,000	Rs. 23,730
4	Rs. 23,730	Rs. 2,373	Rs. 25,000	Rs. 1,103
5	Rs. 1,103	Rs. 110.30	Rs. 25,000	Rs. 0

**Interest Calculation:**

**Year 1:**

Outstanding balance at the beginning of Year 1: Rs. 80,000 (Total cost - Down payment)

Interest for Year 1: 10% of Rs. 80,000 = Rs. 8,000

Installment paid: Rs. 25,000

Outstanding balance at the end of Year 1: Rs. 80,000 + Rs. 8,000 - Rs. 25,000 = Rs. 63,000

**Year 2:**

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Outstanding balance at the beginning of Year 2: Rs. 63,000  
Interest for Year 2: 10% of Rs. 63,000 = Rs. 6,300  
Installment paid: Rs. 25,000  
Outstanding balance at the end of Year 2: Rs. 63,000 + Rs. 6,300 - Rs. 25,000 = Rs. 44,300

**Year 3:**



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Outstanding balance at the beginning of Year 3: Rs. 44,300  
Interest for Year 3: 10% of Rs. 44,300 = Rs. 4,430  
Installment paid: Rs. 25,000  
Outstanding balance at the end of Year 3: Rs. 44,300 + Rs. 4,430 - Rs. 25,000 = Rs. 23,730



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**Year 4:**

Outstanding balance at the beginning of Year 4: Rs. 23,730  
Interest for Year 4: 10% of Rs. 23,730 = Rs. 2,373  
Installment paid: Rs. 25,000  
Outstanding balance at the end of Year 4: Rs. 23,730 + Rs. 2,373 - Rs. 25,000 = Rs. 1,103

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**Year 5:**

Outstanding balance at the beginning of Year 5: Rs. 1,103  
Interest for Year 5: 10% of Rs. 1,103 = Rs. 110.30  
Installment paid: Rs. 25,000  
Outstanding balance at the end of Year 5: Rs. 1,103 + Rs. 110.30 - Rs. 25,000 = Rs. 0

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**Total Interest Paid:**

Year 1: Rs. 8,000  
Year 2: Rs. 6,300  
Year 3: Rs. 4,430  
Year 4: Rs. 2,373  
Year 5: Rs. 110.30

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Total Interest = Rs. 8,000 + Rs. 6,300 + Rs. 4,430 + Rs. 2,373 + Rs. 110.30 = Rs. 21,213.30

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**Conclusion:**

XYZ Ltd. will pay a total interest of Rs. 21,213.30 over the period of five years, in addition to the principal amount of Rs. 1,00,000.

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Assignment

**Ques 1:** ABC Ltd. purchases a vehicle costing Rs. 3,00,000 on hire purchase basis. The terms are:  
Down payment: Rs. 60,000  
Four annual installments of Rs. 70,000 each  
Interest charged at 12% per annum on the outstanding balance.  
Calculate the total interest payable by ABC Ltd. over the hire purchase period.

**Ques 2:** XYZ Electronics Ltd. buys machinery worth Rs. 5,00,000 on hire purchase. The terms include:  
Initial payment: Rs. 1,00,000  
Five equal annual installments of Rs. 80,000 each  
Interest at 15% per annum on the reducing balance method.  
Compute the total interest paid by XYZ Electronics Ltd. by the end of the hire purchase agreement.

**Ques 3:** PQR Motors Ltd. acquires equipment valued at Rs. 8,00,000 through hire purchase. The agreement details are:  
Initial payment: Rs. 1,60,000  
Six annual installments of Rs. 1,00,000 each  
Interest charged at 10% per annum on the outstanding amount.  
Determine the total interest amount paid by PQR Motors Ltd. over the hire purchase period.

**Ques 4:** LMN Pvt. Ltd. decides to purchase computers costing Rs. 10,00,000 on hire purchase. The terms are:  
Down payment: Rs. 2,00,000  
Eight quarterly installments of Rs. 1,00,000 each  
Interest at 8% per annum on the outstanding balance.  
Calculate the total interest payable by LMN Pvt. Ltd. throughout the hire purchase tenure.



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