

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.

**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:** X purchases a car on hire-purchase system on 1.1.11. The total cash price of the car is Rs 4,50,000 payable. Rs 90,000 down and three installments of Rs 1,70,000, Rs 1,50,000 and Rs 1,08,460 payable at the end of first, second and third year respectively. Interest is charged at 10% p.a.

You are required to calculate interest paid by the buyer to the seller each year.

**Solution:**

To calculate the interest paid by the buyer each year under the hire-purchase system, we need to break down the installments and compute the interest for each year. Here's the step-by-step solution:

**Given Data:**

Cash Price of the Car: Rs. 4,50,000  
Down Payment: Rs. 90,000

**Installments:**

1st Year: Rs. 1,70,000  
2nd Year: Rs. 1,50,000  
3rd Year: Rs. 1,08,460  
Interest Rate: 10% p.a.

**Calculating the Balance and Interest for Each Year:**

**1. Calculate the initial outstanding principal after down payment:**

Initial Outstanding Principal = Cash Price - Down Payment  
 $4,50,000 - 90,000 = 3,60,000$

**2. First Year:**

Opening Balance: Rs. 3,60,000

Interest for the first year:  $3,60,000 \times 0.10 = \text{Rs. } 36,000$   
 Total due at the end of the first year:  $3,60,000 + 36,000 = \text{Rs. } 3,96,000$   
 Installment paid: Rs. 1,70,000  
 Principal repaid:  $1,70,000 - 36,000 = \text{Rs. } 1,34,000$   
 Outstanding Principal after the first installment:  $3,60,000 - 1,34,000 = \text{Rs. } 2,26,000$

### 3. Second Year:

Opening Balance: Rs. 2,26,000  
 Interest for the second year:  $2,26,000 \times 0.10 = \text{Rs. } 22,600$   
 Total due at the end of the second year:  $2,26,000 + 22,600 = \text{Rs. } 2,48,600$   
 Installment paid: Rs. 1,50,000  
 Principal repaid:  $1,50,000 - 22,600 = \text{Rs. } 1,27,400$   
 Outstanding Principal after the second installment:  $2,26,000 - 1,27,400 = \text{Rs. } 98,600$

### 4. Third Year:

Opening Balance: Rs. 98,600  
 Interest for the third year:  $98,600 \times 0.10 = \text{Rs. } 9,860$   
 Total due at the end of the third year:  $98,600 + 9,860 = \text{Rs. } 1,08,460$   
 Installment paid: Rs. 1,08,460  
 Principal repaid:  $1,08,460 - 9,860 = \text{Rs. } 98,600$   
 Outstanding Principal after the third installment:  $98,600 - 98,600 = 0$

### Summary of Interest Paid Each Year:

First Year:  
 Interest: Rs. 36,000

Second Year:  
 Interest: Rs. 22,600

Third Year:  
 Interest: Rs. 9,860

Thus, the interest paid by the buyer to the seller each year is Rs. 36,000 for the first year, Rs. 22,600 for the second year, and Rs. 9,860 for the third year.

### Assignment

#### Question 1:

X purchases a car on hire-purchase system on 1.1.11. The total cash price of the car is Rs 5,50,000 payable. Rs 1,20,000 down and three installments of Rs 2,00,000, Rs 1,80,000, and Rs 1,18,460 payable at the end of the first, second, and third year respectively. Interest is charged at 10% p.a.

You are required to calculate the interest paid by the buyer to the seller each year.

**Question 2:**

A purchases a bike on hire-purchase system on 1.1.20. The total cash price of the bike is Rs 1,80,000 payable. Rs 30,000 down and three installments of Rs 70,000, Rs 60,000, and Rs 48,950 payable at the end of the first, second, and third year respectively. Interest is charged at 10% p.a.

You are required to calculate the interest paid by the buyer to the seller each year.

**Question 3:**

B purchases a refrigerator on hire-purchase system on 1.1.21. The total cash price of the refrigerator is Rs 2,40,000 payable. Rs 40,000 down and three installments of Rs 80,000, Rs 91,100, and Rs 69,190 payable at the end of the first, second, and third year respectively. Interest is charged at 10% p.a.

You are required to calculate the interest paid by the buyer to the seller each year.

**Question 4:**

C purchases a laptop on hire-purchase system on 1.1.22. The total cash price of the laptop is Rs 1,20,000 payable. Rs 20,000 down and three installments of Rs 53,000, Rs 39,200, and Rs 30,106 payable at the end of the first, second, and third year respectively. Interest is charged at 12% p.a.

Calculate the interest paid by the buyer to the seller each year

**Solved Example: Hire Purchase System - Calculate the total cost of the machinery, including interest.**

**Question:** A company purchases machinery under a hire purchase agreement with the following terms:

- Cash price of machinery: Rs. 1,50,000
- Down payment: Rs. 30,000
- Number of installments: 4 annual installments of Rs. 30,000 each, starting from the end of the first year.
- Interest rate: 12% per annum, charged annually.

Calculate the total cost of the machinery, including interest.

Solution:

**Calculate Principal Amount:** Total cash price of machinery = Rs. 1,50,000  
Down payment made = Rs. 30,000  
Principal amount financed through hire purchase = Rs. 1,50,000 - Rs. 30,000 = Rs. 1,20,000

**Calculate Interest for Each Year:** Annual interest rate = 12%

Year 1: Interest on Rs. 1,20,000 = 12% of Rs. 1,20,000 = Rs. 14,400

Year 2: Interest on remaining principal (Rs. 1,20,000 - Rs. 30,000) = 12% of Rs. 90,000 = Rs. 10,800

Year 3: Interest on remaining principal (Rs. 90,000 - Rs. 30,000) = 12% of Rs. 60,000 = Rs. 7,200

Year 4: Interest on remaining principal (Rs. 60,000 - Rs. 30,000) = 12% of Rs. 30,000 = Rs. 3,600

**Calculate Total Interest Paid:** Total interest = Rs. 14,400 + Rs. 10,800 + Rs. 7,200 + Rs. 3,600 = Rs. 36,000

**Calculate Total Cost of Machinery:** Total cost = Cash price + Total interest = Rs. 1,50,000 + Rs. 36,000 = Rs. 1,86,000

**Conclusion:** The total cost of the machinery, including interest, is Rs. 1,86,000.

### Assignment

Ques 1: A company purchases office equipment under a hire purchase agreement with a cash price of Rs. 1,50,000. The terms include an initial payment of Rs. 30,000 and three annual installments of Rs. 40,000 each, starting from the end of the first year. The interest rate charged is 8% per annum. Calculate the total cost of the office equipment, including interest.

Ques 2: Mr. B buys a delivery van under hire purchase for Rs. 3,00,000. He makes an initial payment of Rs. 60,000 and agrees to pay the balance in four equal annual installments, starting from the end of the first year. The interest rate applicable is 12% per annum. Calculate the total interest paid and the total cost of the delivery van.

Ques 3: A construction company purchases a bulldozer for Rs. 5,00,000 on hire purchase. They pay Rs. 1,00,000 initially and agree to pay the remaining amount in five equal annual installments, starting from the end of the first year. The interest rate is 15% per annum. Calculate the total cost of the bulldozer, including interest.

Course & Test Series

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Ques 4: Ms. C buys a printing machine for her publishing business on hire purchase for Rs. 2,00,000. She pays Rs. 50,000 initially and agrees to pay the remaining amount in three annual installments of Rs. 50,000 each, starting from the end of the first year. The interest rate charged is 10% per annum. Calculate the total interest paid and the total cost of the printing machine.

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