

LEASING

DEFINITION

- “A lease is an agreement whereby the lessor conveys to the lessee ,in return for rent the right to use of an asset for an agreed period of time” (ICAI)
- OR
- A financing arrangement that provides a firm with the advantage of using an asset without owning it may be termed as leasing.

CHARACTERISTICS

1.TWO PARTIES

- 1.LESSOR-The owner of the asset who gives the right of usage to another person.
- 2.LESSEE-The person who obtains the right to use the asset from the lessor for a periodical rental payment for an agreed period of time.

2.The Asset

- Leasing is used for financing fixed assets of high value and can include a machine, a building,etc.
- Throughout the period of lease ownership essentially rests with the lessor and only right of usage is given to the lessee.

3.LEASE PERIOD

- The term of the lease is called the lease period.
- Every lease is legally required to have a specified period in the lease agreement after which the asset goes back to the lessor.

4.LEASE RENTALS

- Lease rentals as mentioned in the lease agreement include costs such as interest on the lessor's investment, any repair and maintenance if so mentioned, depreciation and service charges etc.

TYPES OF LEASE

1.FINANCIAL LEASE

- “It is a lease under which the present value of the minimum lease payments at the inception(begining) of the lease exceeds or is equal to substantially the whole of the fair value of the leased asset” (ICAI)
- A financial lease is non-cancelable in nature.
- The lessee is responsible for maintenance of the asset and the agreement is usually renewed on completion of the term.

TYPES OF FINANCIAL LEASE

- 1.FULL PAYOUT LEASE
- In this type of lease the lessor recovers the full value of the leased asset within the period of the lease by way of lease rentals and residual value.
- 2.TRUE LEASE
- In this tax related benefits such as investment tax credit ,depreciation tax shields etc are offered to the lessor.

2. OPERATING LEASE

- A type of lease where the asset is not fully amortized during the period of the lease and where the lessor does not rely on the lease rentals for profit.
- It is for a shorter period of time compared to the life of the asset.
- It can be cancelled by the lessee on short notice and can also be renewed on expiry.
- Maintenance of the asset is the responsibility of the lessor though he can charge this from the lessee.

3.NET LEASE

- It is a type of lease in which the lessor is not concerned with the repairs and maintenance of the asset and his only function is to provide the service.
- It is a variant of operating lease.

4. Conveyance Type Lease

- A very long term lease applicable to immovable properties.
- The usual period may be as long as 99 to 999 years

5.LEVERAGED LEASE

- When the financial value of the asset is very high this type of leasing is used.
- Here the full or part financial requirement is arranged through a financier.
- The lessor may himself act as a financier and charge an amount in excess of the lease rental for this purpose or he may arrange a separate financier for the lessee.

6.SALE AND LEASE BACK

- In this type of lease the owner of an asset sells it to the lessor and then leases it from him.
- This exchange of title has the effect of providing finance to the owner and also helps to release the funds tied up in that particular asset.

7.PARTIAL PAY-OUT LEASE

- It is a type of lease where the lessor obtains the full payment of the lease in several leases.
- It falls under the category of an operating lease.

8.CONSUMER LEASING

- It is the process of leasing consumer durables such as TV, Refrigerators etc.

9.BALLOON LEASE

- It is a type of lease which has zero residual value at the end of the lease period.
- In this lease the rentals are low at inception(beginning) of the agreement, high in between and again low towards the end.

10.CLOSE END LEASING

- An arrangement whereby the asset leased out is returned to the lessor at the end of the lease period.

11.OPEN END LEASING

- A lease involving an additional payment, the amount of which will depend on the value of the property when it is returned.
- It is so called because the lessee does not know the actual cost of the asset till the end of the period when it is actually sold.

12.SWAP LEASING

- In this the lessee has the right to exchange the asset leased out whenever the original asset has to be sent to the lessor for repair or maintenance.

13.WRAP LEASING

- A lease transaction typically involving a lease from an investor to an operating lease company with a sublease by the operating lease company to the end-user lessee.
- Typically, the operating lease company acquires the equipment and leases it to an end-user lessee.

14.IMPORT LEASING

- The leasing of imported capital goods.
- It is beneficial to the lessee because arranging other funds may take him a long time and the prices of the importable item as well as the exchange rates may change.

PROCEDURE FOR IMPORT LEASING

(refer xerox)

- 1.PERMISSION
- 2.LEASE AGREEMENT/HP OPTION
- 3.CONDITIONS
 - A) Provision for leasing in the company's memorandum of association
 - B) Issued and paid up capital of Rs 1 crore(minimum)
 - C) The company's shares have to be listed on any stock exchange.
- 4.ENDORSEMENT OF IMPORT LICENCE
- 5.COMPLIANCE
- 6.FREE TRADE ZONE(FTZ) PERMISSION
- 7.CONSENT LETTER

15.CROSS BORDER LEASE

- Where the lessor and the lessee are in two different countries and governed by separate jurisdictions.
- The intention is to avail of income tax and depreciation benefits and reduce the financial cost to the lessee.

16.DOUBLE DIP LEASE

- In this case the lessee has the benefits of depreciation tax twice due to the differing tax laws in the two countries.

JAPANESE CROSS BORDER LEASING

- It falls under three categories namely
- 1.Samurai lease-for acquiring large value items through cheap foreign currency loans given by EXIM Bank.
- 2.Shogan Lease-A law was passed whereby Japanese firms could lease assets to other countries.
- 3.Mushashi Lease-Leasing in foreign currency.

TYPES OF LESSORS

- Specialized leasing companies
- One-off lessors
- Manufacturer- lessors
- Banks sponsored leasing companies
- Financial institutions

Types of Lessees

- A wide range of companies both big and small

Lease Brokers

- Intermediaries between lessors and lessees who help find a suitable lessor for a lessee.
- Lease Financiers -Banking institutions that provide finance to the lessor for acquiring an asset.

LEASING PROCESS

- STEPS
- 1. Lease Selection
- 2. Order and Delivery
- 3. Lease Contract
- 4. Lease Period

SERVICES OF LESSOR

- Provision of Credit Facility
- Absorbing obsolescence risks
- Comprehensive package

ADVANTAGES OF LEASING

TO LESSOR(owner)

- Stable business
- Sale of supplies
- Second hand market
- Wider distribution
- Easy finance
- Fillip to capital market
- Tax benefits

TO LESSEE

- Efficient use of funds
- Cheaper source
- Flexible source
- Enhanced borrowing capacity
- Off balance sheet financing
- Tax benefits
- Favorable terms
- Guards against obsolescence
- No initial cash outlay
- Better liquidity

LIMITATIONS OF LEASE FINANCING

- Disguised debt financing
- Double sales tax
- Loss of tax shield
- Loss of residual value
- No ownership
- No working capital
- Costly option
- Risk of default
- Unfavorable gearing
- Indiscriminate finance
- Long term venture

FINANCIAL IMPLICATIONS

FOR LESSEE

- Tax shield on lease rentals is available as business expenditure.
- Depreciation tax shield not available.
- Tax shield on lease rentals is a cash inflow.
- Tax shield on depreciation is a cash outflow.

FOR LESSOR

- Tax shield on lease rentals is not available as business expenditure.
- Depreciation tax shield is available.
- Tax shield on lease rentals is a cash outflow.
- Tax shield on depreciation is a cash inflow.
- Net salvage value of an asset is post-tax cash flow.

Sources of Funds for leasing companies

- Deposits
- Bank Borrowings-with RBI regulations with respect to
- 1.Maximum limit-From all sources not to exceed 10 times net owned funds, and three times of fully engaged equipment leasing companies.
- 2.Nature of facility/probable future lease rentals.