

# **The Tanzania Leasing Project: Developing Leasing as a Financial Product**

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## **I. Introduction**

The International Finance Corporation (IFC) with support of the Swiss Government's State Secretariat for Economic Affairs (SECO) is implementing a 2 & ½ year project in Tanzania to develop and support the growth of financial leasing. The project, known as the Tanzania Leasing Project ("TANZALEP") among other things, provides Technical Assistance and capacity building to the Government of Tanzania, in order for the Government to put in place appropriate and enabling legal, regulatory and taxation environment for financial leasing. Based on the Project's initial work and consultation, there is consensus that an enabling tax, legal and regulatory framework is an essential pre requisite for leasing development in Tanzania.

At this stage of the Project, and after extensive consultation with stakeholders, the Project has submitted its proposals for appropriate leasing taxation and legal framework to the Ministry of Finance and Bank of Tanzania, two government institutions to which the Project is accountable. The Project has made available these recommendations to stakeholders, including commercial and development banks that are already in the leasing market, the technical committee of the Tanzania Bankers Association, prospective leasing companies, institutional investors, and various departments within Government.

In addition to its work with Government, TANZALEP provides leasing product /business development support to banks, prospective leasing companies, equipment supply companies, institutional investors, and micro leasing companies. It provides training and capacity building to professional associations, firms and regulators, and mobilizes domestic and international investment for leasing.

The Project team is pleased that there is growing interest amongst commercial and development banks, equipment suppliers, and institutional investors to develop financial leasing in Tanzania.

## **II. Why Financial Leasing?**

IFC considers financial leasing an important product to further capital investment, SME development, domestic production, industrial diversification as well as infrastructure improvements, and hence overall economic growth of a country. Leasing also helps to deepen financial markets. Leasing can meet the objectives of various stakeholders in Tanzania, including those of Government, enterprises, (whether large, medium or small), equipment suppliers, commercial and development banks, and independent leasing companies.

For Banks and leasing companies, financial leasing can meet the following objectives, among others:

- **Risk management/ reduction**

A leasing company/bank maintains legal ownership of the leased asset, is able to exert greater control over the investment, can monitor assets more easily, and can apply specialized knowledge such as

Equipment specialization.

- **Product portfolio diversification**

Leasing provides an opportunity to extend product lines and to deepen company organizational structures. In some cases, leasing may allow businesses to access both lease financing and additional bank financing without increasing their collateralized debt.

- **Customer base expansion**

Leasing can provide additional marketing channels for financial services. Equipment suppliers can channel customers to leasing companies and banks. Banks can also provide credit lines to independent leasing companies once these are established.

- **Suitable means of financing SMEs**

Due to reduced upfront costs, leasing frees up capital for other business needs (i.e., meets enterprises' cash flow needs). Leasing enables companies to match income and expenditure, and can be tailor-made/ structured to suit the requirements of the lessee, unlike other forms of finance.

### **III. The issues so far:**

#### **A. Developing appropriate Legal (Legislative) and Regulatory Framework**

In recommending for a leasing legislative framework, in this instance a 'leasing law', the Project intends that there should be legal certainty for financial leasing operations. A law is therefore proposed to provide legal certainty, and hence encourage leasing investment, rather than deter operators from the leasing market by providing unnecessary restrictions/burdens for leasing operations.

Legal certainty is necessary for leasing development, especially in order to mobilize and channel available financial resources into leasing operations ('productive sectors'), and to protect the interests of financiers, e.g. by providing clarity on matters such as rights and obligations of parties and allocation of financial risk. Based on the Projects' review of existing law and practice, as well as that of on-going and settled disputes in the judicial system, there is lack of clarity and certainty for financial leasing under the existing framework.

Although there may be different means by which to achieve legal certainty, **TANZALEP** believes that the most efficient and effective way to provide legal certainty for financial leasing in Tanzania is through enactment of a leasing law. At the same time the Project notes concerns amongst the financial services sector regarding the judicial system and dispute resolution in Tanzania. Therefore, while working on a legal framework, **TANZALEP** also provides capacity building to stakeholders in the legal sector, and works with other institutions in legal sector reform.

The Project is likewise working with the Bank of Tanzania to address issues of light regulation of non-deposit taking leasing companies as well as the appropriate framework for the same, should this be deemed necessary. Regulation would be in the areas of minimum capital requirements, entry and exit requirements for leasing companies, and corporate governance. At the same time, the Project will be advising on appropriate prudential regulation.

## **B. Financial Leasing Taxation Framework**

The application of Value Added Tax on financial leasing has been particularly troublesome for practitioners in the leasing market. The essence of **TANZALEP**'s proposals for Value Added Tax is to provide certainty regarding application of VAT on financial leasing, as this has been uncertain leading into undesirable results for leasing practitioners. It is advised that financial leasing is essentially a financial service, and VAT should therefore be applied accordingly. The Project has made a number of recommendations regarding VAT and financial leasing.

**TANZALEP** has also made recommendations with regard to capital allowances and accelerated depreciation for leasing that are different from the existing framework under the Income Tax Act, 2004.

With regard to specific tax incentives for leasing, **TANZALEP** has not advocated for tax incentives as such. However, stakeholders including Government have been made aware of the economic benefits of leasing, with a view that Government may consider incentives for this sector, if appropriate, so as to stimulate investment, economic growth and to widen the tax base.

## **C. Financial Leasing Business Development**

In addition to appropriate legal environment, leasing development requires business/product development services for both established and prospective leasing companies, availability of funding for leasing operations, awareness on the part of the public and enterprises, asset management and monitoring skills, and availability of secondary markets for leased equipment, among other things.

**TANZALEP** is addressing some of these needs, so that the country's financial leasing portfolio can be increased, and so that existing banks as well as new leasing companies whether 'captives' (leasing companies owned by equipment suppliers), independent leasing companies, or commercial banks enter the leasing market.

**TANZALEP**'s business/product development component addresses the following areas:

- funding mechanisms for leasing companies,
- leasing company structures,
- structuring of lease deals,
- legal documentation,
- lease marketing
- lease taxation
- lease accounting; and
- Asset monitoring and management, including developing secondary markets (This component is to be confirmed)

The local team in association with IFC's international experts is able to provide this range of services, either at banking industry level or at individual commercial or development bank level.

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