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I. Definition of leasing

The word “lease” has a number of slightly different meanings, depending on the type of contractual arrangement. The definition may also differ from country to country.

In simple terms, a lease is a contract between two parties, whereby a party that owns an asset (the “lessor”) lets another party (the “lessee”); use the asset for a predetermined time in exchange for periodic payments. In leasing, the legal ownership and the use of an asset are separated.

Paying cash upfront for an asset can be a significant drain on businesses’ working capital. Leasing an asset, however, gives businesses access to assets without having to pay for them up front. All forms of leasing are basically rental agreements giving a lessee the right to use an asset owned by a lessor (finance company or bank) for a specific period of time in return for regular payments known as lease rental payments or simply rental payments.

II. Definition of leasing and its various types

Leases are broadly of two types, finance leases and operating leases.

A Finance lease is an agreement for financing primarily the purchase of equipment and sometimes its use.
A finance lease may be defined in accordance with International Accounting Standard 17 (discussed on page 6) which provides for the criteria to be met in order for a lease to be classified a finance lease. However that definition is more relevant for accounting, and sometimes for taxation purposes.

A more general definition of a finance lease is that it is in agreement used to finance the use and/or acquisition of goods, equipment or assets. In finance leasing, a finance company makes an investment in goods for the benefit of its customer (lessee). The finance company expects to recover the full cost of its investment in the goods through
a lease agreement with the customer under which the customer makes regular rental payments in exchange for use of the asset. The lease installment payments are calculated in a manner that will enable the finance company recover the full cost of its investment in the goods, plus a margin of profit or interest. Usually, in a finance lease, lease rental payments are determined such that their total sum over the lease term will pay off the cost of the asset (i.e., amortize the cost of the asset), including a profit margin or interest for the lessor leasing company / bank.

A typical finance lease is a three party arrangement (see diagram 1) and in most cases provides an option to the lessee to purchase the equipment after expiry of the lease term.

Diagram 1:

_Three party arrangement in Finance Leasing (Adopted from FAO & GTZ- 2004)_
**Operating lease:** An operating lease is any lease that is not a finance lease, often with a shorter contractual term than a finance lease (always significantly shorter than the working life of the asset). An Operating lease is more like a regular rental agreement. At the end of an operating lease, the lessor expects to be able to either sell the asset in the second-hand market or to lease it again, and will therefore not need to recover the total asset value through lease payments under the first lease. There may be an option to extend the lease period at the end (and this negotiation can only take place at the end of the initial rental period). In an operating lease, the lessor effectively retains a significant amount of the risks and rewards of ownership of the asset. The most common type of operating lease is contract hire, where the lessor undertakes some of the responsibility for management and maintenance (insurance, repairs, and license) of the vehicles. In other forms of leasing, asset maintenance and management are the sole responsibility of the lessee. In operating leases, the lessor also takes residual value risk in the lease transaction.

**Contract Hire:** Is a form of operating lease (often used for cars and other vehicles) that includes a number of additional services such as maintenance, management, or replacement if the goods are in repair. A contract hire is short term in nature, e.g. 2 or 3 days or a couple of weeks, usually not exceeding six months.

**Hire –Purchase:** This is an agreement for the hiring of an asset with an option on the hirer to purchase the asset. In a hire-purchase agreement, legal title to the asset will pass to the hirer when all hire purchase payments have been made and the option to purchase the asset has been exercised. Hire Purchase agreements are typically written for domestic users, and not so much for business users. There can sometimes arise confusion between the term finance lease and hire purchase because the terms are sometimes used differently in different countries. This is explained below.
Sale and lease-back. This is an agreement similar to a finance lease except that in a sale and lease-back the lessee is the initial owner of the equipment, where after the lessee sells the goods to the lessor and enters into a contractual agreement to lease back the goods from the lessor through payment of regular rentals. This arrangement is useful in order to fulfill enterprises’ working capital needs.

Finance Lease Vs Hire Purchase: A Hire Purchase agreement is essentially a finance lease transaction, as it is an agreement used to finance the acquisition of assets. However, the terms hire—purchase and finance lease may sometimes be defined and/ or used differently in different countries and can therefore be confused. In India and England, for example, a finance lease does not have an option to purchase the asset at the end of the lease term, and therefore a lease with an option to purchase is for, legal and tax purposes, defined as a hire-purchase. In other countries, a lease transaction with a purchase option is referred to as a finance lease and the term hire-purchase is not used. Again in some countries, for taxation purposes, the contractual term of a hire purchase agreement must be significantly shorter than the working life of the asset. In these instances, the hirer is able to claim capital allowances as if he/she had purchased the asset outright, gaining immediate use of it.

Some common law countries, including those in Africa - e.g. Tanzania, Ghana and Malawi - have hire purchase legislation written in their statute books. However the experience is that this legislation has rarely been used since enactment. Many developed countries have either repealed Hire Purchase legislation, not used it since enactment or merged it with consumer protection legislation, and therefore hire—purchase in these countries has become a feature of consumer protection legislation, or for the financing of consumer type assets or to consumers, however defined. The Tanzania Hire Purchase
legislation has several limitations in so far as it can be used for financing of high cost or other capital goods or equipment. Some of these include: the onerous and one sided obligations imposed on an owner of assets under a hire-purchase agreement, as well as the value of goods that can be financed under a hire-purchase agreement, i.e., only goods of up to Tanzania Shillings 60,000/-. Alternatively, revising this statutory limit upwards will not entirely solve the problem as the legislation overly protects the hirer of goods and sometimes shifts financial risk to the owner (lessor) of goods. Proposals for leasing legislation in Tanzania have distinguished hire-purchase agreements from finance leases.

III. Leasing Versus Other Forms of Asset Based Finance:

Leasing is a form of asset finance in which the decision whether or not to lease an asset to a lessee is made primarily on the basis of the asset’s ability to generate cash flow. Leasing is different from other forms of finance and asset based finance such as conditional sale, chattels mortgage and credit sale. The differences have been elaborated in the International Finance Corporation - Study of the Leasing Market in Tanzania of 2006, and are briefly summarized hereunder:

Chattels Mortgage:
A chattels mortgage is a conveyance of legal ownership or title to goods (movable property) that is given as security by a borrower for the payment of a debt or the performance of a duty. A chattels mortgage is a legal right or interest that a creditor has in a borrowers’ property, lasting usually until a debt or duty that the mortgage secures is satisfied. In this type of asset based finance, the borrower should in the first place have property to mortgage to a lender as security / collateral for credit advance.
Conditional Sale:
A conditional sale agreement is an agreement for sale under which title to goods remains in the seller until the purchase price for the assets has been paid in full or the buyer has complied with any conditions prescribed by agreement for the transfer of title to him. Apart from the reservation of title provisions, a conditional sale agreement has all the normal incidents of a contract of sale.

Credit Sale:
Contracts of this kind pass legal ownership of an asset immediately, with the supplier or finance house providing finance facilities. Unlike conditional sale contracts, there is no retention of legal ownership / title by the seller.

IV. Benefits of leasing – to lessee, lessor, and the economy
Leasing offers various advantages over other means of financing. The most important ones and suitable for SME’s are:

a) No-collateral requirements
In leasing, collateral / security is seldom required because the leased goods serve as security for the finance advanced. The lessor retains legal ownership over the asset, and in the event of default, the lessor can repossess the goods, a relatively straightforward process in most countries. In Tanzania, however, repossession procedures have not been straightforward as lessees have often obtained court injunctions to prevent lessors from repossessing assets.

b) Simple to structure lease deals/low transaction costs. A lease can be concluded more quickly and simply than a bank loan. The lessor is only interested in
determining the ability of the leased goods to generate sufficient cash flow to pay monthly rentals throughout the lease term.

c) **Tax Incentives:** In many countries the tax system is normally conducive to leasing. Tax incentives differ from country to country. In Korea, for example, the lessor registers the full lease payment (principal + interest) as income but deducts the accelerated depreciation of the assets. The lessee claims the lease payment (rentals) as deductible. The lease term is usually shorter than the economic life of the equipment, so the lessee in fact depreciates the equipment faster than if the asset was purchased. In Tanzania it is different, the lessee is the party entitled to claim depreciation and the interest portion of the lease rentals is registered as income to the lessors.

d) **Leasing offers a way to modernize production** and develop small businesses; allows technological refresh and sometimes provides off balance sheet financing (for countries where finance lease is classified as a “lease” and not a loan).

V. Parties and Responsibilities of parties to a finance lease transaction:

(a) **Finance leasing as a three party transaction:**

There are different opinions whether finance leasing is a three party or a two party arrangement. The International Finance Corporation (IFC) differentiates a finance lease agreement, which it believes to be a two party agreement between a lessor and lessee, from a financial lease transaction; which it believes to be a three party transaction.
involving an enterprise (as lessee), an equipment supplier (as lessor), and a bank, finance or leasing company (as intermediary financier). IFC is interested in promoting leasing as a financial product and believes that operating leases could be best left to contract. IFC also believes, however, that operating leases can be legislated for if countries require legislative guidance for these types of leases.

(b) Rights and Obligations of the Supplier

A supplier or vendor of goods in a finance lease transaction is a party that sells, or otherwise transfers title to goods, to a lessor (bank/leasing company); which goods the lessor leases to the lessee. There may be other ways by which leases can be entered into between a lessor and lessee, including through the appointment of the lessee as agent of the lessor to purchase the assets from the supplier on its behalf. The prevalent practice in Tanzania has been for lessees to directly select vendors/suppliers and equipment of their choice without involvement of the lessor, for lessors to pay the supplier for the equipment selected; and for suppliers to transfer legal title to goods to the lessor.

In a finance lease, the lessor requires the lessee to select the supplier/vendor and equipment of its choice and that is suitable for its purpose without intervention from the lessor. The lessor, as part of its asset control and management responsibilities, may want to ensure that goods selected by the lessee are of good quality. Although lessees select goods from suppliers directly, the suppliers/vendors raise and address any tax, sales invoices or other documents that evidence the lessor’s legal title to the goods, including, a sale/purchase/supply agreement in the name of the lessor in order to ensure that the lessors acquires good title to the goods as legal security for the credit supplied.
On the other hand, a supplier/vendor or manufacturer of goods owes duties with regard to goods that it supplies. These duties have to do with the quality of goods and sometimes with the fitness for purpose for which the goods are being acquired. In certain instances, a supplier of goods may retain maintenance responsibilities in respect of the goods. Finance leasing requires that if goods under finance lease are found unsuitable or defective, the lessee should not be able to avoid the finance lease agreement with the lessor, but rather, should seek compensation from the supplier under the terms of the warranties attached to the goods.

In common law countries, the legal issue that a three party finance lease arrangement raises, is that it is usually not possible for the lessee to enforce contractual obligations with regard to the goods directly against the supplier, as usually there will be no direct contractual relationship between the two parties. In Tanzania, the common law principle of privity to contract may prevent a lessee from taking direct action against a supplier of goods for lease. The aforementioned has been at issue under the existing legal framework applicable to finance leasing. The proposed leasing law for Tanzania enables lessees to take direct action against suppliers in the event of supply of defective goods under a finance lease agreement, but prevents the lessor and lessee both taking action against the supplier for the same defect. The lessees’ right to take action against the supplier is subject to provisions of the law and terms of the suppliers’ warranties for defects in goods.

**Rights and Obligations of the Lessor**

The foremost (and usually the only) obligation of a lessor to a lessee in finance leasing is to ensure that the lessee is entitled to ‘quiet enjoyment and use’ of the leased goods, without interference by the lessor or by third parties who claim a superior title to the
leased asset. This means that the lessor is obliged to ensure that it acquires good title to the leased asset and that it surrenders possession of the asset, for the lessee’s use, without unlawful interference or negligence on the lessor’s part.

The lessor may assign the lease agreement to another lessor, usually without having to obtain the consent of the lessee. In an assignment, the new lessor is obliged to respect the terms of the lease agreement and to provide for quiet enjoyment and use of the asset by the lessee, provided that lessee abides to the terms of the lease agreement.

Rights and Obligations of the Lessee

In a finance lease, the lessee’s utmost obligation to the lessor is to meet its rental obligations as specified under the lease agreement. Once a lease agreement has been accepted by the lessee, the lessee’s duties towards the lessor become ‘irrevocable’. In other words, the lessee becomes entitled to make rental payments specified in the lease and not to withhold rentals or to default on rental payments under any circumstances. This is the so called ‘hell or high water’ principle that forms the essence of a finance lease agreement. The rationale of this principle is that a finance lease is similar to a term loan; and for the health of the financial system borrowers should be obliged to return credit advanced to them.

Other duties of a lessee include the duty not to assign the leased goods without the consent of the lessor; the duty to maintain the leased goods in good condition, fair wear and tear excepted, and the duty to notify the lessor of damage to the equipment, among other duties, which may be specified under the lease contract and or under leasing legislation.
VI. Accounting for leasing transactions

Accounting for leasing is governed by the International Accounting Standard No. 17 (Revised 2003 and adopted in 2005).

(a) Objective of IAS 17

The objective of IAS 17 is to prescribe to parties, lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.

Scope

IAS 17 applies to all leases other than lease agreements for minerals, oil, natural gas, and similar regenerative resources and licensing agreements for films, videos, plays, manuscripts, patents, copyrights and similar items (IAS 17.2) However, IAS 17 does not apply as the basis of measurement for the following leased assets:

- Property held by lessees that is accounted for as investment property for which the lessee uses the fair value model set out in IAS 40;
- Investment property provided by lessors under operating leases (IAS 40); and
- Biological assets held by lessees under finance and operating leases (IAS 41).

(b) Applicability of IAS 17

Whether a lease is a finance lease or not depends on the substance of the transaction rather than the form. A lease is classified as a finance lease if it transfers substantially
the risks and rewards incident to ownership. Examples of situations which would normally lead to a lease being classified as a finance lease are:

- The lessor transfers ownership of the asset to the lessee by the end of the lease term;

- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable; such that, at the inception of the lease it is reasonably certain that the option will be exercised;

- The lease term is for the major part of the economic life of the asset even if title is not transferred;

- At the inception of the lease the present value of the minimum lease payments is greater than or equal to substantially all of the fair value of the leased asset; and

- The leased assets are of a specialized nature such that only the lessee can use them without major modifications being made.

Other situations that might also lead to classification as a finance lease are: (IAS 17.11)

- If the lessee is entitled to cancel the lease, the lessor’s losses associated with the cancellation are borne by by the lessee;

- Gains or losses from fluctuations in the fair value of the residual fall to lessee (for example, by means of a rebate of lease payments); and
The lessee has the ability to continue to lease for a secondary period at a rent that is substantially lower than market rent.

In classifying a lease of land and buildings, land and buildings elements would normally be separated. The minimum lease payments (MLP) are allocated between the land and buildings elements in proportion to their fair values. The land element is normally classified as an operating lease unless title passes to the lessee at the end of the lease term, while the building element is classified either as an operating or finance lease depending on the classification criteria in IAS 17 above.

VII. Accounting for Finance Leases

(a) Accounting by Lessees

The following principles should be applied in the financial statements of the lessees:

- At commencement of the lease term, finance leases should be recorded as an asset and a liability at the lower of the fair value of the asset and the present value of the minimum lease payments (discounted at the interest rate implicit in the lease, if practicable, or else at the enterprise’s incremental borrowing rate): [IAS 17.20];

- Finance lease payments should be apportioned between the finance charge and the reduction of the outstanding liability (the finance charge to be allocated so as to produce a constant periodic rate of interest on the remaining balance of the liability): [IAS 17.25];

- The depreciation policy for assets held under finance leases should be consistent
with that for owned assets. If there is no reasonable certainty that the lessee will obtain ownership at the end of the lease the asset should be depreciated over the shorter of the lease term or the life of the asset.

(b) Accounting by Lessors

The following principles should be applied in the financial statements of lessors:

- At commencement of the lease term, the lessor should record a finance lease in the balance sheet as a receivable, at an amount equal to the net investment in the lease (IAS 17.36);
- The lessor should recognize finance income based on a pattern reflecting a constant periodic rate of return on the lessor’s net investment outstanding in respect of the finance lease.

VIII. Taxation of Leasing In Tanzania

(a) The Income Tax Act 2004

Leasing transactions are specifically provided for under section 32 of the Income Tax Act 2004 reproduced verbatim hereunder;

- Payments made by a person under a finance lease or in acquiring an asset under an installment sale (other than an installment sale that provides for commercial periodic interest payable on balance outstanding) shall be treated as interest and a repayment of capital under a loan made by the lessor or seller to the lessee or buyer, as the case requires.
- Payments made to a person under an annuity shall be treated as interest and a
repayment of capital under a loan made by the person to the payer of the annuity.

• The interest and repayment of capital under 1&2 above shall be calculated as if the loan were a blended loan with interest compounded six-monthly.

• Where an asset is leased under a finance lease, the lessor shall be treated as transferring ownership of the asset to the lessee.

• Where a person transfers an asset under an installment sale or, by lease, the person shall be treated as deriving an amount in respect of the transfer equal to the market value of the asset immediately before the transfer: and the person who acquires the asset shall be treated as incurring expenditure of an equal amount in acquiring the asset.

• Where the lessee under a finance lease returns the asset to the lessor before ownership passes to the lessee shall be treated as transferring ownership of the asset back to the lessor.

(b) Application of Income Tax on leasing

• The lessee is treated as the owner of the property; and

• The lessor is treated as having made a loan to the lessee, in respect of whom payments of interest and principal are made to the lessor, equal in amount to the rental payable by the lessee.
• The interest component of each payment under the loan is treated as interest expense incurred by the lessee and interest income derived by the lessor.

(c) The **Income Tax Act 2004** defines “Finance lease” as a lease where:-

• The lease agreement provides for transfer of ownership following the end of the lease term or the lessee has an option to acquire the asset after expiry of the lease term for a fixed or presupposed price;

• The lease term exceeds 75 percent of the useful life of the asset;

• The estimated market value of the asset after expiry of the lease term is less than 20 percent of its market value at the start of the lease asset;

• In the case of a lease that commences before the last 25 percent of the useful life of the asset, the present value of the minimum lease payments equals or exceeds 90 percent of the market value of the asset at the start of the lease term; or

• The asset is custom-made for the lessee and after expiry of the lease term the asset will not be of practical use.
Table showing accounting and tax treatment by lessors and lessees for both Finance and Operating leases.

<table>
<thead>
<tr>
<th>Criteria for classifying leases as finance leases</th>
<th>Accounting Standards</th>
<th>Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The lessor transfers ownership of leased asset at end of lease term.</td>
<td></td>
<td>The lease agreement provides for transfer of ownership at the end of the lease term or the lessee has option to acquire the asset.</td>
</tr>
<tr>
<td>2. The lessee has the option to purchase the asset at a price which is sufficiently lower than the fair value at the date the option becomes exercisable such that at the inception of the lease, it is reasonably certain that the option will be exercised.</td>
<td></td>
<td>The estimated market value of the asset after expiry of the lease term is less than 20 percent of its market value at the start of the lease</td>
</tr>
<tr>
<td>3. The lease term is for the major part of the economic life of the asset even if title is not transferred.</td>
<td></td>
<td>The lease term exceeds 75 percent of the useful life of the asset.</td>
</tr>
<tr>
<td>4. At the inception of the lease the present value of the minimum lease payments is greater than or equal to substantially all of the fair value of the leased asset.</td>
<td></td>
<td>For the lease that commences before the last 25 percent of the useful life of the asset, the present value of the minimum lease payments equals or exceeds 90 percent of the market value of the asset at the start of the lease term.</td>
</tr>
<tr>
<td>Accounting Standards</td>
<td>Taxation</td>
<td></td>
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<tr>
<td>----------------------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td><strong>Recognition of revenue and expense under a finance lease</strong></td>
<td>1. Interest portion of the lease payment is recorded as interest income or expense on an accrual basis calculated by the effective interest rate method.</td>
<td>The same.</td>
</tr>
<tr>
<td></td>
<td>2. The lessee depreciates the leased property, per accounting policy of the company.</td>
<td>Capital allowances are allowed at specified rates and are calculated on a class by class basis rather than asset by asset. Rates do not necessarily reflect the economic life of the asset as they could be used to provide incentives to certain industries.</td>
</tr>
<tr>
<td><strong>Recognition of revenue and expense under an operating lease</strong></td>
<td>1. Lease payments and contingent payments are recognized as revenue or expense when due on straight line basis.</td>
<td>The same.</td>
</tr>
<tr>
<td></td>
<td>2. The lessor depreciates the leased asset in the same manner as its own property.</td>
<td>Capital allowances claimed in accordance with rates specified in the income tax laws.</td>
</tr>
<tr>
<td><strong>Bad debts</strong></td>
<td>Provisions against leases are estimated on a reasonable and objective basis.</td>
<td>Only leases actually written off after all reasonable recovery effort has been exercised are allowed.</td>
</tr>
</tbody>
</table>
Treatment of capital allowances Vs depreciation (initial allowances etc)

The range of qualifying assets for capital deductions covers almost all tangible and intangible assets, hence entitlement of depreciable allowances for almost all kind of leased assets. See appendix “A” for the schedule on allowances for assets under Tanzanian law.

(a) The treatment of Investment allowances on leased equipment

The purchase of capital goods/items for use in designated priority investment sectors is exempt from Value Added Tax and import duty. The investor has to obtain a Certificate of Incentives from the Tanzania Investment Centre in order to enjoy this benefit. Investment tax code and the law at present do not allow the lessee to claim the tax incentives in respect of leased capital goods.

(b) Value Added Tax

- Leasing is deemed as both a supply of goods and credit; therefore leasing transactions are subject to VAT.

- All lease transactions except the leasing of land and residential buildings are subject to VAT in Tanzania.

- A lessor is required to be registered for VAT if its aggregate taxable turnover from all businesses sources exceeds Shs 40 million per annum.

- An operating lease is considered to be a supply of services for VAT purposes; therefore VAT is due on all rentals received by a lessor.

- Finance lease is a supply of goods and financial services (credit/loan).

- Repossession of goods is outside the scope of VAT as it is neither a supply of goods nor services.
• The lessor may adjust output tax on repossessed goods.
• The sale of repossessed goods is a taxable supply.
• The Lessees are required to account for output tax on goods they lease from overseas lessors (import of service).

What is the current practice in the Tanzanian Market?
• For capital goods, there is no VAT applicable - VAT is not levied.
• For non-capital goods, e.g. motor vehicles leases, the VAT amount is capitalized and added to the acquisition cost to determine the final amount due to the lessor.

(c) Stamp Duty

Lease agreements are chargeable to stamp duty under the Stamp Duty Act 1972.

IX. Lease vs Purchase Analysis

It is a common dilemma, i.e., whether to lease or purchase-(lease or buy equipment). Which is better? Everyone who has ever considered leasing has had this question cross their minds. So what is the answer?

The answer is: It depends.

Leases and loans are simply two different methods of asset financing. One finances the use of equipment, the other finances the purchase of equipment. Each has its benefits and drawbacks. It is not possible to say that one is better than the other because the answer depends on the specific set of circumstances.
When making a “lease or buy” decision you must look not only at financial comparisons but also at your own personal priorities—what is important for you. Things like, is having new equipment every two or three years with no major repair risks more important than long-term costs, or are long term cost savings more important than lower monthly payments? Are having some ownership of equipment more important than low up-front costs and no down payment? Is it important to you to pay off your equipment and be debts-free for a while, even if it means higher monthly payments for the first few years? So, making the lease or buy decision is not quite cut and dry.

The chart next page provides basic criteria that can be used as a guidance principle in the decision of lease versus buy.
<table>
<thead>
<tr>
<th>Issue/consideration</th>
<th>Lease</th>
<th>Buy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Down payment</td>
<td>Minimal depending on the type of the lessee company and risk level.</td>
<td>Small to large, can go up to 50 percent.</td>
</tr>
<tr>
<td>Effect on bank lines</td>
<td>Usually considered an additional credit line.</td>
<td>Decrease by total cost of equipment.</td>
</tr>
<tr>
<td>Effect on operating capital</td>
<td>Minimal, due to small down payment, and low monthly cost of true lease.</td>
<td>Could be substantial if high down payment and short term loan.</td>
</tr>
<tr>
<td>Payments</td>
<td>Low fixed monthly cost.</td>
<td>Usually higher than a lease.</td>
</tr>
<tr>
<td>Insurance</td>
<td>Can be incorporated in lease payments paid by lessee</td>
<td>Must be included in existing policy.</td>
</tr>
<tr>
<td>Tax issue</td>
<td>Possible accelerated depreciation over lease term.</td>
<td>Depreciated over useful life of the asset.</td>
</tr>
<tr>
<td>Hidden costs</td>
<td>Nominal application fee-can generally be reduced or eliminated</td>
<td>Storage, disposal cost.</td>
</tr>
<tr>
<td>Flexibility</td>
<td>Can add-on-upgrade.</td>
<td>Very little-difficult and often expensive to upgrade.</td>
</tr>
<tr>
<td>Obsolescence</td>
<td>Simply trade up to latest technology.</td>
<td>Generally obsolete before it is paid for—upgrades can be expensive.</td>
</tr>
<tr>
<td>Hedge against inflation</td>
<td>Payments do not change.</td>
<td>Payment may change.</td>
</tr>
<tr>
<td>Approval process</td>
<td>Generally easy due to the low monthly cost. Often can be paid for out of operating budget.</td>
<td>Must get approval for entire amount.</td>
</tr>
<tr>
<td>Application difficulty</td>
<td>Relatively Fast and simple.</td>
<td>Can involve lengthy approval process and substantial paperwork.</td>
</tr>
</tbody>
</table>
X. Risks in Leasing

Leasing like any other business is prompt to various risks that may affect pricing of the lease products. The main types of risks of leasing in are as follows:

i) **Lease portfolio risk**- Risk of non-servicing of lease installment payments by the lessee as scheduled.

ii) **Residual Value risk**- This refers to the value that leased equipment is expected to maintain at the end of the lease term. Predicting / estimating future value of the asset is a difficult task which may have impact on determining unreasonable lease payments.

iii) **Asset Management Risk:**

Further categorised into:

- **Maintenance and repair risk** associated with use and maintenance of the equipment. Since lessees do not own the equipment and may not opt to own it at the end of the lease, there is risk that the equipment may be kept in a poor state of repair.

- **Tracking and monitoring risk.** The lessor should be able to monitor the equipment regularly as equipment can be vandalized or removed from outside the territory etc.

- **Title risk.** The lessor should ensure that it acquires good legal title to the goods.

- **Procurement and merchantability risk.** The lessor will need to ensure (for its own security) that the lessee procures equipment that is of good quality.
iv) **Cost of capital risk.** One reason why leasing is more attractive to SMEs than loans is that loans that are available to SMEs are mostly short term in nature, while leases on the other hand have a longer term linked to the economic life of the equipment. In most cases, and especially in developing countries, it is difficult to raise fixed-rate medium term finance cheaply. Sometimes lessors are forced to finance leases from several short-term borrowings. Since the rate of interest prevailing for every subsequent borrowing cannot be predicted with certainty, the aftermath is to reduce the profitability of the lease due to the shifting cost of capital during the lease term.

v) **Changes in tax regulations.** Sudden changes in tax regulations may significantly affect profitability expected from leases.

**XI. Documenting lease transactions**

Documents Used to Document Lease Transactions are as follows:-

The legal documents used to create a finance lease of equipment are commonly:

- Master Lease Agreement or a Lease Agreement (or both);
- Finance Lease Schedule;
- Purchase Agreement;
- Maintenance Agreement,
- Buy – Back Guarantee; and
- Other Miscellaneous documents.
Below these documents are described in detail:

(a) **Master Lease Agreement**

A Master Lease Agreement is an agreement that allows for the leasing of goods from time to time.

The Master Lease Agreement contains all the principal provisions (terms and conditions) pursuant to which all subsequent leasing business between the lessor and lessee is to be conducted. A Master Lease Agreement does not refer to specific assets or to specific financial terms for the lease of particular goods which would be encapsulated in separate lease agreements when the specific goods are leased.

The purpose of a Master Lease Agreement is to allow for the incorporation of leasing of different goods, as and when such need arises. For this reason, the Master Lease reduces on-going transaction costs for parties. The Master Lease Agreement controls later leases or subleases, particularly of parts of the leased property, and does not include details of the goods to be leased, length of lease term, rentals or maintenance charges or reserves.

A Master Lease Agreement or a Lease Agreement (if a Master Lease Agreement is not required) may ordinarily contain the following provisions: (This list does not claim to be exhaustive).

- Provisions relating to subject matter of agreement (leased goods);
- Provisions relating to term, rent, and payment;
- Provisions relating to taxes;
- Provisions relating to notification and reporting;
- Provisions relating to delivery, use and operation of goods;
• Provisions relating to maintenance;
• Provisions relating to Insurance;
• Provisions relating to return of equipment;
• Provisions relating to default and remedies for default;
• Provisions for assignment;
• Provisions for hell or high water;
• Provisions regarding indemnification;
• Disclaimer provisions;
• Provisions regarding representations and warranties;
• Provisions for early termination;
• Purchase Option.

If a Master Lease Agreement is utilized, the following is applicable:

• Separate lease agreements are entered into for each good or set of goods being leased.
• Provisions of the Master Lease Agreement are incorporated by reference in each lease Agreement.
• Those specific details not provided for in the Master Lease Agreement: for example, details of specific goods being leased, rentals, maintenance charges, commencement date, duration of lease and so forth are incorporated in the Lease Agreement.
(b) Finance Lease Schedule

The financial lease schedule to the Master Lease Agreement will include the following details:-

Details of equipment subject to the terms and conditions of the lease;
Financial terms, including the following:

- Advance rentals, if any
- Capitalised lessors cost;
- Basic term;
- Basic term lease rate factor;
- Basic term commencement date;
- Option payment;
- First termination date;
- Last delivery date;
- Basic term rent;
- Taxes.

(c) Purchase Agreements

The parties to a purchase agreement will normally be the Vendor and Purchaser.

The Vendor may either be a third party manufacturer, supplier or dealer (except in the case of a sale and leaseback when the Vendor is the Lessee). The Purchaser can be the lessor or the lessee if the lessor and lessee have previously executed an Agency agreement with the lessor appointing the lessee to purchase the goods on behalf of the lessee.
The purpose of a Purchase Agreement is to document the terms of the supply of goods between parties. The agreement should contain specific description of the goods supplied; state when the goods should be delivered to the lessee and the specific location of delivery; incorporate provisions for damages or rescission if the vendor fails to deliver the goods to the lessee on a specified date. The agreement should set out the specific warranties in respect of the goods (and if applicable, that the benefit of such warranties may be assigned); the purchase price of the goods and the payment terms applicable.

(d) Maintenance Contracts

Parties to a Maintenance Contract will normally be the lessee and a third party manufacturer, supplier of dealer or lessor or such other party providing maintenance services.

The purpose of a Maintenance Contract is to specify the terms and conditions by which leased goods are maintained. Maintenance Contract should make provision for: leased goods to be maintained from time to time based on usage or after periodic intervals, fixed / variable maintenance charge, replacement goods (if possible) and review of maintenance records. The contract should provide for where repairs can be undertaken.

(e) Buy-Back Agreements

Parties to a Buy-Back Agreement will usually be the Lessor and a third party manufacturer, supplier or dealer providing the buy-back guarantee.

The Lessor has the right to require the vendor / supplier to re purchase the goods at a pre-determined price or at a price ascertained in accordance with pre-determined formula. The buy-back agreement must cater for the obligation to re purchase the goods if the lease agreement is terminated by effluxion of time or upon earlier termination of
the lease. A pre-determined formula would have to be used to calculate the repurchase price if the lease is terminated prior to the stipulated termination date. The supplier will wish to make obligation to buy-back at pre determined price subject to compliance with pre-agreed use, maintenance and return conditions. The supplier may want to be able to deduct from the pre-determined repurchase price excess wear and tear and / or usage charges.

(f) Personal Guarantees

Leasing companies in less developed leasing markets usually require additional security for a finance lease. In these markets, it is common for leasing companies to require that the lessee provide a personal guarantee made by a third party in respect of the lease agreement. The Guarantor, under a Guarantee Agreement, will guarantee to the lessor payment of outstanding lease payments in event of the lessees’ default on the lease agreement.

However, it is important to ensure that personal guarantee is backed by realizable security (property), as in some cases the undertaking that a third party will be liable in respect of the default of the lessee is not backed by identified property that the lessor can realize as security, and it has therefore proven difficult to enforce a personal guarantee.

(g) Other Miscellaneous Agreements:

(i) Agency Agreement Between Lessor and Lessee

An Agency Agreement may be necessary if the lessee is purchasing goods from a supplier/vendor which assets will in turn be leased to the lessee. The agency relationship may or may not be disclosed to the supplier depending upon whether the lessee wishes the supplier to be aware of the proposed leasing relationship.
(ii) Landlord’s Waiver & Lender’s Waiver

A Landlord’s Waiver will be required where a lessee leases goods from a lessor, and those goods are affixed to immovable property that belongs to a third party, the landlord. The landlord in this case should provide a waiver that as long as the goods are under lease, the leased property shall not become part of the land, and that the landlord shall not have any rights to the same.

A Lender’s Waiver may be required where a lessee is a corporate entity that has issued debentures which charge the company’s property to other third party lenders. A lessor of goods for financial lease may require a company to which it leases goods to obtain a Waiver from those other lenders that the property under finance lease shall not form part of the Company’s assets. Lenders Waivers are useful instruments in countries where movable asset registries are underdeveloped and inefficient. By obtaining a Lenders Waiver, a lessor will effectively ring fence / isolate the leased assets from the pool of company assets.

(iii) Documents of Legal Ownership/ Title

In leasing, evidence of ownership of leased assets by a lessor is critical for successful leasing operations. It is necessary for the lessor to be able to assert and evidence ownership over leased assets and protect its proprietary and financial interest in the asset as against the lessee and other third parties claiming an interest in the leased asset.

Common documents used by lessors to assert ownership or as proof of ownership over movable property include Bills of lading, sales / tax invoices, bills of sale, sales or supply agreements, and other documents commonly used in the sale or supply of goods from suppliers to lessors. In Tanzania, certain moveable property is registered and ownership
of such property (motor vehicles, air craft, and ships) can be evidenced by title registration cards issued by relevant registration authorities. In Tanzania, the new motor vehicle registration system allows for joint registration of a lender and borrower on the vehicle registration card (under a chattels mortgage), with the lender being the Title holder of the asset, and the borrower being the Legal owner. Leasing requires the lessor be registered as legal owner.

**XII. Registration of Leases / Assets**

Registration or notification of goods / assets under lease in a general registry system serves important legal and practical functions for leasing operations. The availability of a register in which interests in leased assets can be registered serves the function of notifying third parties of the extent of the parties’ interests in leased assets and that the lessee, can not create interests in the leased asset in favour of third parties without the lessor’s knowledge and consent.

A lessee under a finance lease cannot pass title to leased assets to third parties. This is because a lessee under a finance lease does not obtain title to leased assets until payment in full of the lease rentals plus profit has been made (full amortization), and the leased asset has been purchased by him at nominal or whatever rate agreed under the terms of the lease agreement. However, under the common law, it may be possible for a third party purchaser in good faith and for value who purchases a leased asset from a lessee to gain title over a leased asset, where such third party purchaser has no knowledge that the assets are legally owned by a third party, the lessor.

In common law countries, registration of interests in leased assets constitutes notice to the public of the interests created by the parties whether or not third parties have had
access to, and checked the registries. Where interests are registered, a third party purchaser for value of leased assets from the lessee is assumed to have notice of the lease, whether or not he accessed the public register.

In Tanzania, it is possible for lessors to register lease agreements or to record interests in leased assets with the Registrar of Titles, who is also the Registrar of interests in Chattels.

**XIII. Asset Monitoring, Preservation and Management**

Although in finance leasing it is common to provide that maintenance and preservation of leased assets are the responsibility of the lessee, nevertheless, prudent lessors will ensure regular monitoring of the asset against possibility of vandalism or damage or removal of the leased assets from the territory. Some leasing companies have fully fledged asset monitoring departments. Running successful leasing operations requires that assets are properly monitored to ensure preservation and maintenance.

**XIV. Repossession And Termination of Leases**

(a) Termination Events

Sometimes under a lease agreement, the primary lease period (i.e., the period under which the lessor anticipates recovery of its investment) may end early. In this event the lessor will not receive all the anticipated primary period rentals, and it is therefore vital to identify in the finance lease agreement all situations in which early termination may occur, and in each case, the manner in which the lessor is to be paid out in the event of the early termination.
There are three normal situations where early termination of a lease agreement may occur:

- Voluntary termination;
- Total loss; and
- Default

**(i) Voluntary Termination**

The lessor should check the period of notice required for termination of the finance lease agreement. For financial reasons, the lessor may wish to restrict the right to terminate the lease towards the end of its financial year. Upon termination by the lessee, the lessee should be liable to pay a termination sum.

**(ii) Termination on Total Loss**

Total loss may be defined as not only total destruction of the asset, but also damage beyond economic repair and, sometimes, requisition or other compulsory loss of the asset. Depending on the equipment there may also need to be provision for total loss or part of the equipment e.g. if 10 out of 50 vehicles are lost.

Procedure for notifying insurers and for payment of insurance proceeds should be included in the lease agreement. There should be an obligation on the lessee to pay a termination sum at a specified date. This date may be deferred somewhat to allow for receipt of insurance proceeds. If such proceeds are received, they may be applied to reduce the termination sum due. However, any shortfall must be the contractual liability of the lessee.
If insurance proceeds are received after the lessor has been paid out or if they exceed the termination sum, then they (or the surplus) will be rebated to the lessee.

If the termination sum does not fall due until after a rental payment date then the provision will usually stipulate for the rental payment to be paid (and the termination sum reduced accordingly), notwithstanding the goods have already become a total loss. Total loss may have significant credit risk implications for the lessee if the equipment is central to its business. Any deferral of the termination sum, while convenient, should therefore be considered carefully by the lessor.

(iii) Termination for Default

There should be a list of events of default similar to that in a loan agreement, but including acts which imperil the value of the assets leased.

The following provides a guideline on issues of default:

- A list of events which distinguish major breaches of the finance lease terms from minor breaches (e.g. by including suitable grace periods for remedy); in particular a provision that time of payment of rent is to be of the essence of the contract;
- Language which supports the argument that the lessee has repudiated the lease agreement if one of the default events occurs;
- A right to recover a termination sum as liquidated damages;
- A provision which will give credit to the lessee if the lessor realizes value from the repossessed equipment.
**Under English law**, a termination sum may be unenforceable as a penalty unless:

- The lessor can demonstrate that the lessee repudiated the lease i.e. that the breach complained of was a breach of condition and
- The termination sum is a genuine pre–estimate of loss and not a penalty.

(b) **The Termination Sum under A Finance Lease**

The sum which the lessor will need to receive on early termination for any reason will comprise of the following:

- Any arrears of rent plus interest accrued on the same;
- Costs and expenses associated with the termination e.g. repossession, storage or insurance charges.
- Costs of reinstating the goods, if necessary, to the condition required by the lease (probably good working condition fair wear and tear excepted).
- Consequential expenses e.g. costs of breaking fixed funding or unwinding funding arrangements (if relevant).

**Loss of future rentals:** This head of loss has caused most problems under English common law. The lessor’s requirement is to receive a sum equal, at the date of payment, to the then present value of the future rent stream. There are at least two ways of calculating this sum which are in common use:-

- *The discount method:* each rental is discounted at a specified rate from the date on which it would have fallen due to the date of payment of the termination sum. The discount rate is for agreement between the parties.
• **The stipulated loss table:** the lessor calculates a table of termination values using a method similar to that for calculating the rentals, and based on various taxation assumptions.

In each type of termination (voluntary, total loss, default) the lessor will need to receive a termination sum. Note that the problem of penalties only applies on default termination.

(c) **Disposal of Leased Assets on Termination**

Upon termination of a finance lease, the leased equipment should be disposed at fair market value at the time of sale.

(d) **Repossession**

The essential legal character of a finance lease is that the lessor of goods is and remains, legal owner of the goods throughout the term of the lease. Title to the leased property remains at all time with the lessor, until such time at the end of the finance lease, that the lessee exercises the option to purchase the leased property. It is because of the legal nature of a finance lease, that where a lessee defaults on the lease agreement, the lessor should be able to repossession the leased property efficiently and with minimum delay.

Previous experience in repossession shows that repossession in Tanzania has in practice been hampered by lessees’ obtaining court injunctions to prevent lessors from repossessioning. In Tanzania the Civil Procedure Code Act of 1966 makes provision for repossession of immovable assets under lease. The correct reference should be made to both moveable and immovable assets under lease as finance leasing in Tanzania primarily involves moveable property.
The Right to Repossess Goods By Self Help

In most jurisdictions, repossession of leased assets can only be done upon a lessor obtaining a court order for repossession, having given the lessee adequate notice of its intention to repossess the goods. This will usually be under expedited judicial procedure.

Self-help repossession can occur whereby a lessor of goods is entitled to repossess leased assets without court order but on its own motion using self help methods. This method is recognized under certain jurisdictions, especially in the common law. The rationale for self-help repossession is that lessors are legal owners of leased assets and should therefore be able to resort to self-help methods to repossess their assets. Where self-help repossession is not recognized in the law, complications may arise for the lessor, as the lessor may be held liable for trespass where it seeks to enter the lessee’s premises to repossess assets without lawful authority. It is therefore recognized that ‘self-help’ repossession should resort to certain established principles, for example, that require ‘non-breach of the peace’.

In Tanzania, the practice for repossession is that self-help methods are exercised with or without the help of Police. The law in Tanzania does not prohibit self-help repossession and formerly, leasing companies had resorted to these methods. On the other hand, banks doing asset finance through chattels mortgages have tended to seize assets without seeking Court Orders. The proposed leasing law for Tanzania recognizes self-help repossession methods and allows financiers to resort to these in so far as the methods employed do not breach the peace. It should be appreciated that the logic of self help is two fold: (i) that the leasing company is the legal owner; and (ii) that leased assets are depreciating assets whose recovery should not be delayed.
XV. Enforcement of Contract – Legal Action

Successful leasing operations require that financial leases should be enforceable between parties to the lease, as well as against third parties. In the event of default of lease contractual terms, parties should be able to exercise remedies that are specified under the terms of the financial lease. However, owing to the nature of the assets and the contract, these terms should be enforceable in an efficient and expedient manner. For example, provisions in a lease agreement requiring the lessee to pay a termination sum or liquidated damages for default or upon termination of the lease should be enforceable. The legal action necessary to enforce such provisions should be expedient, and parties should not have to wait unduly long for legal process as leased assets are usually fast depreciating assets.

In Tanzania a summary procedure for enforcement of debts under finance lease contracts has not been provided for under the Civil Procedure legislation. Summary procedure for financial leasing can promote development of this service as financiers would have confidence in expedient recovery of money’s advanced to borrower lessees.

XVI. Challenges Facing the Leasing Market In Tanzania

(a) Public Awareness

Finance leasing is a relatively new product in the market and requires a concerted effort to sensitize members of the public including SMEs, the banking and financial services community, professionals, business schools and business associations on operations and benefits of leasing.
(b) Legal Framework

IFC believes that the legal framework for leasing in Tanzania is inadequate, and that it does not encourage investment in leasing operations by leasing companies or banks & financial institutions to offer the product widely in the market.

IFC believes that the following issues need to be clarified and expressly provided for in the legal framework for lease financing to develop:

(i) Clarity of rights and responsibilities and allocation of risks amongst parties to a finance lease transaction.

IFC believes that a finance lease transaction encompasses both the transaction between the leasing company and lessee, as well as the equipment supply company and the lessor. The rights and responsibilities of the three parties in a finance lease transaction under the current legal framework are not adequately provided for and have resulted into disputes.

(ii) Expedient repossession and enforcement of lease contract terms

IFC believes that expedient repossession measures should be recognized by the law to encourage financial leasing, and that efficient mechanisms for enforcement of lease contractual terms between the parties, be incorporated in the law.

(iii) Clarity of third party liability arising from use of leased assets

Liability for third party injury arising from use of leased assets is not clear under the current legal framework and should be spelt out.

(iv) Clarity on third party interests in leased assets –

The current legal framework does not provide with clarity the interests that can or cannot be created by either party to a finance lease over leased assets. This should be done in order to protect the interests of parties to leasing.
(c) Taxation – VAT, Income Tax and Investment Allowances

(i) Value Added Tax

(a) Review of the VAT Act is required in order to provide for clear definition of a finance lease, as well as its clear distinction from other forms of property hire transactions by inserting a special article in the VAT Act to identify a finance lease as a supply of financial services.

(b) Review the VAT Act to identify finance leasing as provision of credit similar to loans, which are currently not subject to VAT. This could be done by including a clause in the VAT Act to exempt interest payment in finance leasing from VAT. Also amend the VAT Act so that VAT is levied on the sale of equipment throughout the whole chain of finance leasing in order to enable VAT off set. Where the leased asset is imported or purchased domestically without VAT, then the lease of these assets should be exempt from VAT.

(c) The leased asset should either be taxed or exempt from VAT depending on whether the asset purchased by the lessor is initially subject to VAT or it is imported with VAT exemption.

(d) The financing method for acquisition of capital goods should not determine whether taxes are or are not imposed. The determining factor for imposition of taxes should be whether the goods are capital goods irrespective of the method by which they are acquired i.e., through leasing. Therefore capital goods purchased under a leasing arrangement should be exempt from VAT and import duty taxes.
(ii) Income Tax

(a) The definition for finance lease as provided for by the Income Tax Act 2004 is not consistent with the definition provided under International Accounting Standards 17. Since the tax treatment for leasing under the Income Tax Act 2004 follows the economic ownership as does the IAS, the definition for finance leasing should also be consistent with IAS 17. This can be done by amending the act by inserting the word “or” for each subsection (a-c) section (32)(7).

(b) Provide flexibility in tax administration for the lessee to be able to claim full capital allowance of the leased equipment within the lease term. For example by allowing accelerated depreciation or the purchase cost of the asset at the end of the lease term to be allowed as deductible for tax purposes etc.

XVII. Support from the IFC

The International Finance Corporation with financial support from the Swiss Government’s State Secretariat for Economic Affairs (SECO) is providing support to the Government of Tanzania and other stakeholders in the private and public sectors, under an Advisory Service project known as the IFC/SECO- Tanzania Leasing Project (“TANZALEP”).
TANZALEP’s work focuses on four main areas detailed below:

(a) Advisory Services for Legal, regulatory and Taxation framework for financial leasing

TANZALEP provides Advisory Services to the Government of Tanzania and other stakeholders for appropriate legal, taxation and regulatory environment for financial leasing to develop. IFC has submitted proposals for leasing legal reform to the Government of Tanzania, prior to which, the proposals were widely circulated to stakeholders in Tanzania in the financial services sector, the private sector and government departments. IFC will offer Technical Assistance for appropriate prudential regulation for leasing companies.

(b) Business Development / Financial Leasing Product Development

TANZALEP works with stakeholders in the private and financial services sector to develop the leasing industry in the country. Work in this area includes training banks and prospective leasing companies on leasing operational issues such as pricing, marketing, and establishing operational guidelines for leasing. The component also includes, support for leasing Management Information Systems (MIS) and mobilizing domestic and international investment for leasing through stakeholders conferences and workshops, and connecting these parties with each other.

(c) Capacity Building

TANZALEP offers training and technical support to Tanzanian institutions and stakeholders, including professional bodies of lawyers and accountants, judges and
magistrates, Universities and business schools. The Project has developed training modules for stakeholders and is currently providing training programmes. In addition, TANZALEP is collaborating with the University of Dar es Salaam to develop short and long term courses in leasing.

(d) Public Awareness

TANZALEP is involved in public information and awareness campaigns on leasing targeted to government, regulators, SMEs, and business associations, among other stakeholders. This is done through sensitization seminars, articles, publications and media appearances. Please log on to our website for leasing information in Tanzania. http://www.ifc.org/africa click TANZALEP on your right.

Micro leasing initiative

TANZALEP supports micro-leasing companies by providing training, support and advisory services to micro leasing companies. TANZALEP tries to connect micro-leasing companies with institutional investors who can provide credit lines for micro leasing activities.
### APPENDIX “A”

**THIRD SCHEDULE**
(Made under section 17 of the Tax Income Act, 2004)

**DEPRECIABLE ASSETS, ALLOWANCES AND INCLUSIONS**

<table>
<thead>
<tr>
<th>CLASS</th>
<th>DEPRECIABLE ASSETS</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Computers and data handling equipment together with peripheral devices, automobiles, buses and minibuses with a seating capacity of less than 30 passengers, goods and vehicles with a load capacity of less than 7 tones: construction and earth-moving equipment.</td>
<td>37.5%</td>
</tr>
<tr>
<td>2</td>
<td>Buses with a seating capacity of 30 or more passengers, heavy general purpose or specialized trucks, trailers and trailer-mounted containers: railroad cars, locomotives and equipment: vessels, barges, tugs and similar water transportation equipment; aircraft; other self-propelling vehicles; plant and machinery (including windmills, electric generators and distribution equipment) used in manufacturing or mining operations; specialized public utility plant and equipment; and machinery or other irrigation installations and equipment</td>
<td>25%</td>
</tr>
<tr>
<td>3</td>
<td>Office furniture, fixtures and equipment; any asset not included in another Class</td>
<td>12.5%</td>
</tr>
<tr>
<td>4</td>
<td>Natural resource exploration and production rights and assets referred to in subparagraph (3) in respect of natural, resources prospecting, exploration and development expenditure</td>
<td>20%</td>
</tr>
<tr>
<td>5</td>
<td>Buildings, structures, dams, water reservoirs, fences and similar works of a permanent nature used in agriculture, livestock farming or fishing farming</td>
<td>20%</td>
</tr>
<tr>
<td>6</td>
<td>Buildings, structures and similar works of permanent nature other than those mentioned in class 5.</td>
<td>5%</td>
</tr>
<tr>
<td>7</td>
<td>Intangible assets other than those in Class 4</td>
<td>1 divided by the useful life of the asset in the pool and rounded down to the nearest half year</td>
</tr>
<tr>
<td>8</td>
<td>Plant and machinery (including windmills, electric generators and distribution equipment) used in agriculture</td>
<td>100%</td>
</tr>
</tbody>
</table>
XVIII. Glossary

**Accelerated Depreciation** – an accounting method that allows a company to write off an asset’s cost at a faster rate than the traditional straight line method that is, not spreading the cost evenly over the life of the asset. This includes any depreciation method that produces larger deductions for depreciation in the early years of a project’s life. It often results in a larger tax deduction on a company’s income statement.

Accelerated cost recovery schemes, through accelerated depreciation, may be allowed for policy and tax purposes. These schemes include double-declining-balance depreciation or sum-of-the-years’ digits depreciation. Accelerated depreciation is a method of speeding up the write off from income of qualifying investments at a faster than normal rate. Annual tax deductions are higher in the first years and diminish in the later years of write off.

**Acceptance Letter** – Generally a letter signed by the lessee signifying the equipment has been delivered; however, this will depend on the terms and conditions of delivery. The letter allows the lessor to pay the vendor. Also called Delivery and Acceptance (D&A).

**Accounting Rate of Return** – The interest rate earned by the lessor in a lease measured by the difference between gross rentals and the value of investment in the lease, calculated on annual basis.

**Accumulated Depreciation** – A financial reporting term for a contra-asset account that shows the total depreciation charges for an asset since acquisition.

**Advance Payments** – One or more lease payments required to be paid to the lessor at the beginning of the term as part of the execution of the lease. Lease structures commonly require one payment to be made in advance. This term also refers to leasing arrangements in which lease payment is due at the beginning of each period.
**Advance Rental** - Any payment in the form of rent made before the start of the lease term. The term also is used to describe a rental payment arrangement in which the lessee pays each rental, on a per period basis, at the start of each rental payment period. For example, a quarterly in advance, rental program requires the lessee to pay one-fourth of the annual rental at the start of each consecutive three-month period during the lease term.

**Amortization** – The process of separating payments into their principal and interest components. An amortized loan is one in which the principal amount of the loan is repaid in installments over the life of the loan, with each payment comprised partially of interest and partially of principal.

**Assign** – To transfer or exchange future rights. In leasing, the right to receive future lease payments in a lease is often transferred to a funding source, in return for up front cash. The up front cash represents the loan proceeds from the funding source, and is equal to the present value of the future lease payments discounted at the leasing company’s cost of borrowing. A lease assigned by the lessor to a funding source is called an assigned lease. The assignment of leases is a very common funding technique used by leasing companies.

**Assignment** – The legal transfer of title to property. The right of the lessor and lessee to transfer their rights and / or obligations under the lease agreement to third parties.

**Balloon Payment** – A large payment at the end of the loan allowing smaller payments to be made during the term.

**Bankruptcy** – An action taken by a party to legally protect its remaining assets by declaring that it cannot pay its debts. Typically, liabilities exceed assets. A common definition in the United States for bankruptcy is interest coverage less than one. A firm is generally forced into bankruptcy not when liabilities are greater than assets, but when
the firm cannot make its interest payments with current earnings before interest and taxes.

**Bargain Purchase Option** - A lease provision allowing the lessee, at its option, to purchase the leased property at the end of the lease term for a price sufficiently lower than the expected fair market value of the property, such that exercise of the option appears at the inception of the lease to be reasonably assured.

**Broker** - An entity which specializes in the arranging of lease transactions between a lessor and a lessee for a fee.

**Capital Allowances** - Depreciation allowances on assets as allowed by income tax provisions of a country.

**Capital Lease** – A lease in the United States is classified as a capital lease if it satisfies any of the following: (a) The lease transfers ownership to the lessee at the end of the lease term; (b) The lease contains an option to purchase the property at a bargain price; (c) The lease term is equal to 75 % or more of the economic life of the property; (d) The present value of minimum lease rental payments is equal to 90 % or more of the fair market value of the leased property less related investment tax credit retained by the lessor. Such a lease is required to be shown as an asset and a related obligation on the balance sheet of the lessee.

**Capitalize** - To record an expenditure that may benefit future periods as an asset rather than as an expense to be charged off in the period of its occurrence.

**Captive Lessor** - A leasing company that has been set up by a manufacturer or equipment dealer to finance the sale or lease of its own products to end-users or lessees.
Certificate of Delivery and Acceptance (D & A) – A document signed by the lessee to acknowledge that the equipment to be leased has been delivered and is acceptable. Many lease agreements state that the actual lease term commences once this document has been signed.

Civil Law – The civil law system is the most common foundation of legal systems around the world. It is an alternative to common law system and, like common law has its roots in Roman law, though civil law resembles Roman law to a greater extent than common law.

In most jurisdictions, civil law is codified in the form of civil codes, but in some it remains uncodified. Most codes follow the tradition of the Code Napoleon in some fashion, though each country may adapt its civil code to local legal tradition, as is done in Germany.

Civil law is employed by almost every country that was not a colony of the British Empire, including Continental Europe, Quebec, Louisiana, the former Soviet bloc, and much of the rest of the world.

Collateral – This refers to the security that is made available to secure finance. In leasing, collateral can be a pledge of property, bank guarantee etc, and usually refers to the leased equipment.

Common Law – Originally based on Roman law, it developed into a tradition of its own England, from where it expanded to the United Kingdom (apart from Scotland), to the United States (apart from Louisiana), and to most former British colonies.

Common law is a system of jurisprudence based on judicial precedents rather than statutory laws. The form of reasoning used in common law is known as case – based reasoning. Common law may be unwritten or written in statutes or codes.
**Common law**, as applied in civil cases (as distinct from criminal cases), was devised as a means of compensating someone for wrongful acts known as torts, including both intentional torts caused by negligence, and as developing body of law recognizing and regulating contracts. Today, common law is generally thought of as applying only to civil disputes.

**Cost of Capital** – The weighted – average cost of funds that a firm secures from both debt and equity sources in order to fund its assets. The use of a firm’s cost of capital is essential in making accurate capital budgeting and project investment decision.

**Credit Reference** - Banks and suppliers used in the lessee’s business and listed on the lease application. Lessor will contact them to check lessee payment habits.

**Credit Scoring** – An objective method of qualifying creditworthiness by assigning numerical values based on a debtor meeting established credit criteria.

**Cross – boarder Leases** – A lease deal under which the lessor is located in one country and the lease is located in a different country.

**Default** – A condition whereby the lessee does not make the payments required by the lease contract.

**Depreciation** – A means for a firm to recover the cost of a purchased asset, over time, through periodic deductions or offsets to income. Depreciation is used in both a financial reporting and tax context, and is considered a tax benefit because the depreciation deductions cause a reduction in taxable income, thereby lowering a firm’s tax liability.

**Discount Rate** – An interest rate used to bring a series of future cash flows to their present value in order to state them in current, or today’s currency. Use of a discount rate removes the time value of money from future cash flows.
**Early Termination** – Premature termination of the contract occurring when a party to a lease fails to meet its obligation under the lease contract, to the extent that entitles the other party (under the law or agreement) to demand such termination.

**Economic Life of Leased Property** – The estimated period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease.

**Effective Interest Rate** – The interest rate on a lease stated on an annual basis. The rate includes the compounding effect of interest during the year.

**End of-term Options** – Stated in the lease agreement, options give the lessee flexibility in its treatment of the leased equipment at the end of the lease term. Common end – of term options include purchasing the equipment, renewing the lease or returning the equipment to the lessor.

**Equipment Schedule** – A document incorporated by reference into the lease agreement that describes in detail the equipment being leased. The schedule may state the lease term, commencement date, repayment schedule, and location of the equipment.

**Equipment Specifications** – A special description of a piece of equipment that is to be acquired, including, but not limited to, equipment make, model, configuration, and capacity requirements.

**Estimated residual value of Leased Property** – The estimated fair value of the property at the end of the lease term.

**Fair Market Value (FMV)** – The value of a piece of equipment if it were to be sold in a transaction determined at arm’s length, between a willing buyer and a willing seller, for equivalent property and under similar terms and conditions.
**Finance Lease** – Finance leases transfer substantially all the risks and rewards incident to ownership to the lessee.

**Full – payout Lease** – A lease in which the lessor recovers, through the lease payments, all costs incurred in the lease plus an acceptable rate return, without any reliance upon the leased equipment’s future residual value.

**Funding** – The process of applying to the manufacturer of the equipment for the equipment being placed on lease.

**Funding Source** – An entity that provides any part of the funds used to pay for the cost of the leased equipment. Funds can come from either an equity funding source, such as the ultimate lessor in a lease transaction, or a debt funding, such as a bank or other lending institution.

**Guaranteed residual Value** – A situation in which the lessee or an unrelated third party (for example, equipment manufacturer, insurance company) guarantees to the lessor that the leased equipment will be worth a certain fixed amount at the end of the lease term. The guarantor agrees to reimburse the lessor for any deficiency realized if the leased equipment is salvaged subsequently at an amount below the guaranteed residual value.

**IAS-17** – International Accounting Standard (IAS) 17 on lease accounting was published by the IAS committee in London in September 1982 and has been updated regularly. IAS- 17 prescribes, for lessees and lessors, the accounting policies and disclosure to apply to leases.

**Implicit Rate** – The discount rate that, when applied to the minimum lease payments (excluding executory costs) together with any unguaranteed residual, causes the aggregate present value at the inception of the lease to be equal to the fair market value (residual by any lessor retained investment tax credits) of the leased property.
Inception of a Lease – The date of signing of the lease commitment or agreement where the property to be leased has been constructed or has been acquired by the lessor, otherwise, the date construction is completed or the property is acquired by a lessor.

Incremental Borrowing Rate of Interest – The interest rate the lessee would have to pay on a similar lease. Or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with similar security, the funds necessary to purchase the asset.

Independent Lessor – A type of leasing company that is independent of any one manufacturer, and as such purchases equipment from various unrelated manufacturers. The equipment then is leased to the end-user or lessee. This type of lessor also is referred to as a third party lessor.

Initial Direct Costs – Costs incurred by the lessor that are directly associated with negotiating and consummating a lease. These costs include but are not limited to commissions, legal fees, costs of credit investigations, and the cost of preparing and processing documents for new leases acquired.

Insured Value – A schedule included in a lease which states the agreed value of equipment at various times during the term of the lease, and establishes the liability of the lessee to the lessor in the event the leased equipment is lost or rendered unable during the lease term due to a casualty.

Interest – The difference between the total loan payments and original loan amount (principal). Interest is to a loan as earned income is to a lease.

Interest Expense – An amount paid to a lender in return for a loan. Typically the interest is paid out over time, accompanied by a reduction in loan principal.
Interest Rate Implicit in a Lease – The discount rate, which, when applied to minimum lease payments and unguaranteed residual value, causes the aggregate present value at the beginning of the lease term to be equal to the fair value of the leased property at the inception of the lease minus any investment tax credit retained by the lessor.

Internal Rate of Return (IRR) – Financial analysis technique used to assess the profitability of an investment proposal. The internal rate of return is the rate at which the cash flow associated with an investment sum to zero upon discounting. The rate thus computed is compared with the cost of capital to arrive at a judgment on the financial viability of an investment.

Lease – A contract between the owner of an asset and its user for the hire of that asset. The ownership rests with the lessor, while the right to use the asset is given to the lessee for an agreed period of time in return for a series of rentals paid by the lessee to the lessor.

Lease Agreement – The contractual agreement between the lessor and the lessee that sets forth all the terms and conditions of the lease.

Lease Expiration – The time at which the original term of the lease contract has ended.

Lease Origination – The process of uncovering (through a sales force), developing and consummating lease transactions. Steps in the process include, but are not limited to, prospecting for new lease business, pricing potential transactions, performing credit reviews, and completing the necessary documentation.

Lease payments – Also called rentals. The amount the lessee pays the lessor in return for using the leased equipment.

Lease Rate – The equivalent simple annual interest rate implicit in the minimum lease rentals. This is not the same as the interest rate implicit in a lease, which reflects the compounding effect.
**Lease Term** – The fixed, non cancelable term of lease. Includes, for accounting purposes, all periods covered by fixed – rate renewal options which for economic reasons appear likely to be exercised at the inception of the lease. Includes, for tax purposes, all periods covered by fixed – rate renewal options.

**Lessee** – The user of the equipment being leased.

**Lessor** – The owner of the equipment which is being leased to the lessee.

**Lien** – A security interest on property to protect the lender in the event of lessee default.

**Minimum Lease payments for the Lessee** – All payments the lessee is obligated to make or can be required to make in connection with the leased property, including residual rents or purchase options, but excluding guarantees of lessor’s debt and executionary costs such as insurance.

**Minimum Lease payments for the Lessor** – The payment considered minimum lease payments for the lessee, plus any guarantee by a third party of the residual value or rental payments beyond the lease term.

**Net Present Value** - The total discounted value of cash inflows and outflows from a project or investment.

**Nominal Interest Rate** – Interest rate stated as an annual percentage without including the effect of interest during the year.

**Off - Balance Sheet Financing** – any form of financing such as an operating lease that, for financial reporting purposes, is not required to be reported on a firm’s balance sheet.

**Operating Lease** - A lease arrangement wherein the lessor seeks to recover his investment in a lease by leasing the equipment to more than one lessee. For financial accounting
purposes, an operating lease is a lease that does not meet criteria for a capital lease or
direct financing lease. Also, used generally to describe a short term lease whereby a user
can acquire use of an asset for a fraction of the useful life of the asset. The lessor may
provide services in connection with the lease such as maintenance, insurance, and
payment of personal property taxes.

**Original Equipment Cost (OEC)** - The amount the lessor pays the vendor for the
equipment at the beginning of the lease. Usually includes up-front sales or value added tax.

**Payment Stream** - The rentals due in lease.

**Payments in Advance** – A payment stream in which each lease payment is due at the
beginning of each period during lease.

**Payments in Arrears** – A payment stream in which each lease payment is due at the
beginning of each period during the lease.

**Present Value** – The discounted value of a payment or stream of payments to be received
in the future, taking into consideration a specific interest of discount rate. Present value
presents a series of future cash flows expressed in today’s money.

**Pricing** – Arriving at the periodic rental amount to charge a lessee. A lessor must factor
many variables into its pricing, which may include lease term, lessor targeted yield,
security deposits, residual value and tax benefits.

**Primary Period** – The period, in a finance lease, during which the lessor expects to
recover the full capital cost of the asset, along with the calculated profit.

**Purchase Option** – An option in the lease agreement that allows the lessee to purchase
the leased equipment at the end of the lease term for either fixed amount or at the future
fair market value of the leased equipment.
**Related Parties** – In leasing transactions, a parent and its subsidiaries, an investor and its investees, provided the parent, or investor has the ability to exercise significant influence over the financial and operating policies of the related party.

**Remarketing** – The process of selling or leasing the leased equipment to another party upon termination of the original lease term. The lessor can remarket the equipment or contract with another party, such as the manufacturer, to remarket the equipment in exchange for a remarketing fee.

**Renewal Option** – An option in the lease agreement that allows the lessee to extend the lease term for an additional period beyond the expiration of the initial lease term, in exchange for lease renewal payments.

**Repossession** – a situation in which a lessor reclaims and physically removes the leased equipment from the control of the lessee, usually because of payment default.

**Residual or Residual Value** – The market value of the equipment prevailing at the end of the lease term.

**Sale-Leaseback** – A transaction that involves the sale of equipment to a leasing company and a subsequent lease of the same equipment back to the original owner, who continues to use the equipment.

**Salvage Value** – The expected market value of an asset on the expiration of its useful economic life.

**Secondary Period** – Frequently optional, the period in a finance lease which follows the minimum lease period during which lease rentals are usually placed at nominal value, as the lessor would already have recovered his investment and profit during the primary lease period.
Securitization – the process of selling lease receivables to a separate legal entity that issues stocks and bonds to investors. The investors’ proceeds flow through to the company that sold the receivables, and the investors receive their returns from collecting lessee receivables.

Straight-Line Depreciation – A method of depreciation (for financial reporting and tax purposes) where a capital asset is depreciated by the same amount each year over the asset’s useful life. The cost (or other valuation basis) minus salvage value is divided by the number of years the asset is expected to remain useful and efficient.

Sub-Lease - A transaction in which leased property is re-leased by the original lessee to a third party and the lease agreement between the original parties remain in effect.

Substance versus Form – a concept that implies that the form of a document is subordinate to the intent of the parties involved in the document.

Sum of the Digits Method – A depreciation method for assets providing for the largest proportion of depreciation to be charged at the beginning of the asset’s life, with smaller charges in later years.

Tax written Down Value – The value of an asset after deducting the total capital allowances claimed from the cost of the asset.

Termination Value – The liability of the lessee in the event of termination is set forth in a termination schedule that values the equipment at various times during the lease term. This value is designed to protect the lessor from loss of investment. If the equipment is sold at a price lower than the amount set forth in the schedule, the lessee pays the difference. In the event the resale is at a price higher than in the termination schedule, such excess amounts belong to the lessor. The termination schedule is not the same as the casualty value schedule, insured value schedule or stipulated loss value schedule.
**Third Party Lessor** – An independent leasing company, or lessor, that writes leases involving three parties: 1) the unrelated manufacturer, 2) the independent lessor, and 3) the lessee.

**Ticket Size** – Refers to the cost of equipment being leased. The leasing marketplace is roughly segmented into the small, middle and large ticket markets.

**Two Party Lessor** – A captive leasing company, or lessor, that writes leases involving two parties: 1) the consolidated parent and / or captive leasing subsidiary and 2) the lessee or end-user of the equipment.

**Useful Life** – The period of time during which an asset will have economic value and be usable. The useful life of an asset is sometimes called its economic life.

**Vendor Leasing** – Lease financing offered to an equipment end-user in conjunction with the sale of equipment. Vendor leases can be provided by the equipment vendor (manufacturer or dealer) or a third party leasing company with a close working relationship with the equipment vendor.

**Withholding Tax** – Payable on the rentals received from many cross-boarder leases, depending on the double-taxation arrangements between the countries involved. WHT may be prohibitively high.
XIX. REFERENCES:

7. MacRae, A.,(2003), Legal Aspects of Leasing In England, Norton Rose, United Kingdom.
XX. DONORS OF THE TANZANIA LEASING PROJECT

State Secretariat for Economic Affairs (SECO)

SECO is the Swiss Government’s competence centre for sustainable economic development co-operation.

The IFC / SECO- Tanzania Leasing Project (“TANZALEP”) is implemented with generous support of SECO (www.seco-cooperation.ch). Switzerland participates in the international community’s efforts to help developing countries fight poverty. Each year Switzerland spends approximately Swiss francs 1.5 billion on developing countries, channeled through such international organizations such as the World Bank, the regional development banks and the specialized agencies of the United Nations.

SECO’s objectives in economic development cooperation are:

- To help developing countries reach the stage of development most favourable to growth and investment.
- To mobilize private sector resources as a means of increasing the flow of finance to developing countries, as well as technology transfer.
- To improve the productive and social infrastructure.
- To achieve greater integration of developing countries in international
XXI. INTERNATIONAL FINANCE CORPORATION (IFC)

The Tanzania Leasing Project (“TANZALEP”) was officially launched on the 24th May, 2005. The project is an Advisory services initiative under IFC’s Private Enterprise Partnership for Africa (PEP-Africa) implemented by the IFC and made possible through the generous financial support of SECO (www.seco-cooperation.ch). PEP-Africa is an Advisory services model to implement IFC’s strategic priorities in Africa. PEP-Africa builds on IFC’s investment experience to identify constraints to private investment in Africa and help both governments and private sector address these constraints. The objective of TANZALEP is to improve financing options for small and medium-sized businesses in Tanzania by increasing the volume of lease transactions carried out in the country. For more information, visit www.ifc.org/africa and click on the TANZALEP link found on the right hand column of the site.

ABOUT IFC

The International Finance Corporation, the private sector arm of the World Bank Group, is the largest multilateral provider of financing for private enterprise in developing countries. IFC finances private sector investments, mobilizes capital in international financial markets, facilitates trade, helps clients improve social and environmental sustainability, and provides technical assistance and advice to businesses and governments. From its founding in 1956 through FY06, IFC has committed more than $56 billion of its own funds for private sector investments in the developing world and mobilized an additional $25 billion in syndications for 3,531 companies in 140 developing countries. With the support of funding from donors, it has also provided more than $1 billion in technical assistance and advisory services. For more information, visit www.ifc.org.