A Survey of the Leasing Market in Rwanda

May 2009

Produced by IFC Rwanda CEDP Leasing Development Program
Acknowledgements

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A number of institutions and individuals contributed to the production of this survey. The IFC project team consisted of Brian Kirungi (task team leader), Murekatete Rugege-Karimba, and Belinda Mutesi.

The authors wish to thank all institutions and individuals in Rwanda who gave invaluable insights during the preparation of the survey.
Note to the reader

The Rwanda Leasing Survey is an independent investigative report intended to provide information on the status of the leasing market in Rwanda and assess market growth prospects. The survey is not intended to be a comprehensive investment guide or a substitute for a feasibility study. IFC does not necessarily endorse the findings of the report and makes no express or implied representation or warranty as to its accuracy, completeness or sufficiency.

References to “dollars” ($) in this report are to United States dollars, unless otherwise indicated.
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Foreword

In Rwanda, where the private sector comprises mainly small and medium enterprises, the lack of access to finance is a major obstacle to economic growth and expansion. Most private enterprises lack the required collateral to secure traditional loan financing from banks.

As an alternative to traditional bank loans, leasing offers a more flexible form of financing that in many cases is better suited to the needs of private businesses with limited capital, or to new companies with limited credit history.

Leasing is a contractual arrangement whereby the owner of the asset (lessor) grants the other party (lessee) the right to use the asset in return for a periodic payment, known as lease rentals. Unlike loan financing, under a lease, the lessee requires neither collateral nor commits to large advance capital expenses. Rather than provide security, as in the case of bank loans, a lessee simply has to demonstrate that he or she has sufficient cash flow from operations to cover the lease rentals.

IFC, a member of the World Bank Group, is a recognized leader in developing leasing worldwide through its investment and advisory services offerings. IFC has approved over $1 billion in 103 equipment leasing companies in 58 countries, and has advised on leasing legislation in over 50 countries.

Through IFC’s Rwanda Leasing Development Program, IFC, with support from the governments of Rwanda and the Netherlands, is implementing a project to support the development of leasing in Rwanda.

This survey, the first to be undertaken for the leasing industry in Rwanda, assesses the status of the sector to determine growth prospects, and to make appropriate recommendations to potential investors and other stakeholders.

Brian Kirungi,
Team Leader/Legal Specialist
IFC Rwanda CEDP Leasing Development Program
Executive Summary

The IFC Rwanda Leasing Development Program carried out its first market study on leasing in Rwanda from 2007 to 2008. Rwanda’s leasing sector began with only two banks and one microfinance institution (MFI) in less than one year of leasing operations these 3 financial institutions had transacted leases worth just over US$ 7 million. By June 2008 four other banks and an additional MFI had begun leasing with over US$ 20 million in transacted leases. The value of leasing transactions already processed gives an optimistic outlook for the future of leasing in Rwanda, especially considering it is a new product on the market and that the vast majority of the population has never heard of it. This potential for growth underlines the need to grow and develop leasing as a viable financing alternative to realize its full potential. There are several key areas that need to be improved and harmonized with the existing positive trends.

For several years, Rwandan businesses have relied on bank loans as a source of financing. The current market trend is, therefore, to get a loan because of the misconception that leasing implies never owning the asset. This reliance on the traditional loan rather than the lease has persisted to this day. IFC has, therefore, been working towards educating the public about leasing, including the current players in the market. With the increased understanding of the benefits of leasing, the sector should grow tremendously. Apart from public education, leasing may expand because several financial institutions have approached IFC informing us of their intention to start leasing operations. IFC is optimistic that with an increase in lessors, competition will emerge and result in the reduction of costs for the lessee, and appeal to more businesses.

Prominent among the challenges facing the leasing industry is an inadequate legal and regulatory framework, where gaps in the Leasing Law have been found, and over regulation is still an issue. The law fails to clearly address issues such as repossession in cases of default and there are no clear rights and obligations of the parties. In addition to weaknesses in the law and low capacity in terms of legal skills, the legal system is not well equipped to handle commercial disputes resulting in a long turnaround period for court. The government of Rwanda has identified this weakness and is working earnestly through the Law Reform Commission, a task force that was set up to deal with these constraints. The Law Reform Commission has accepted to present the Leasing Draft Amendment Law that stakeholders drafted with the support of IFC. There have already been some positive changes that benefit leasing, such as the Asset Registry Law, which has been enacted. The government has hired expatriate judges to expedite and administer commercial justice in the now fully functional commercial courts.

The tax and accounting treatment of leasing transactions still remains a challenge for the sector. There however have been some positive developments
with lessors for both finance and operating leases as they are able to claim capital allowances and other deductions related to ownership. Lessees on the other hand are allowed to claim the full rental payments as an expense against taxable income. The only hindrance to this advantage for lessors is that the practice of allowing lessors to claim capital allowances has not yet been enacted into law. It was a mechanism put in place through the good will of the Rwanda Revenue Authority.

The Rwandan Revenue Authority is not the only government institution showing commitment to embrace and push leasing forward. The government’s medium term objectives in the EDPRS, as in the longer term Vision 2020, is to prioritize private sector development and encompass improved forms of financing as instruments of poverty reduction. The government’s commitment to zero tolerance for corruption, deregulation and privatization are significant opportunities for the leasing sector to exploit.

1. Background

1.1 IFC CEDP Rwanda Leasing Development Program

IFC Rwanda CEDP Leasing Development Program is a joint partnership involving IFC, the Dutch Ministry of Foreign Affairs, through the Netherlands Partnership Program and the government of Rwanda through the Competitiveness and Enterprise Development Project. The program commenced work in September 2006 and was officially launched in March 2007.

The program aims to create new financing opportunities for businesses in Rwanda by promoting leasing as an alternative financing mechanism. The program has four main components.

- Legislative Review – by working to enhance the legislative, tax and accounting environment for leasing in Rwanda.
- Capacity Building – providing training for lessors, lessees, government officials, and other stakeholders in the leasing industry.
- Business Development – creating opportunities for new local and foreign investment in leasing through developing linkages between lessees, equipment manufacturers and financial institutions.
- Public Education – increasing public knowledge and awareness of leasing among all stakeholders through publications, the print and electronic media.
1.2 Objectives of the Survey

This survey of the leasing market in Rwanda is intended to provide independent information on the status of leasing in the country, and to assess the market growth prospects. The study aims to provide market players, potential investors and other stakeholders with information on Rwanda’s leasing sector. It is, however, not intended to be a comprehensive investment guide or a substitute for a feasibility study.

While drawing from IFC’s vast experience in promoting and developing leasing markets in over 50 countries, the survey analyses the leasing market in Rwanda, looking at challenges facing the sector, and making recommendations for further development of the sector.
2. Methodology

Information for the survey was sourced from available publications, desk research, and interviews with public and private sector industry players. All leasing providers active in the market during the period under review were consulted to draw from their experience.

The survey also relied extensively on a study commissioned by IFC, and conducted by Ernst and Young on the impact of the tax and accounting environment on the development of the leasing sector in Rwanda.

A key limitation of the survey was the fact that existing leasing providers have been in operation for a relatively short period. Owing to this, there was not enough information to conduct a detailed trend analysis of the sector. Projections in this report should therefore be seen as generalized indicators of likely future trends.
3. Country Profile

3.1 Physical Background

Small and landlocked between Uganda, Democratic Republic of Congo, Burundi and Tanzania, Rwanda has a mountainous topography with the highest peak, Mount Karisimbi, lying at 4,500m above sea level in the North Western province. The watershed of the Nile and Congo rivers dissects the country from north to south, and high rainfall maintains the lush tropical vegetation, lakes, and forests. With nine million people, Rwanda has one of the highest population densities in Africa (337 people per sq. km), 92 percent of which is concentrated in rural areas. The official languages spoken are English, French, and Kinyarwanda. Swahili is also spoken in commercial centers.

<table>
<thead>
<tr>
<th>Real GDP Growth Rate Percentage (2004 -2008)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table ...: Real GDP and Inflation trends 2004-2008</td>
</tr>
<tr>
<td>(in billions RWF unless otherwise indicated)</td>
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<tr>
<td></td>
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<tr>
<td>2004</td>
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<tr>
<td>Est.</td>
</tr>
<tr>
<td>Real GDP</td>
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<tr>
<td>Real GDP Growth (%)</td>
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<tr>
<td>Inflation (annual % average)</td>
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<tr>
<td>Nominal GDP</td>
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</tbody>
</table>

Source: Minecofin

Foreign exchange controls have been liberalized and the banking system is sound and thriving. Interest rates have remained stable at an average of 16 percent over the past five years, lower than in many African countries with similar fundamentals. The country is one of the largest external aid recipients in Africa (about 50% percent of the government’s budget in both budget and project support, though this is expected to reverse as the country consolidates its domestic resource mobilization efforts).
3.2 Political Background

Rwanda became independent in 1962 after German and then Belgian administrations. After a number of political upheavals culminating in the 1994 Genocide, Rwanda has registered remarkable recovery, and currently has a democratically-elected government led by His Excellency, Mr. Paul Kagame. During his tenure, the government has placed a strong emphasis on reconciliation, and has largely succeeded in forging a sense of national, rather than ethnic identity in Rwanda.

3.3 Economic Background

Over the years Rwanda has put in place prudent macroeconomic policies that have led to economic stability. The objective of these policies has been to ensure real GDP growth, stabilize inflation and a sustainable external position while ensuring debt sustainability to achieve poverty reduction.

Real GDP, which had fallen by almost half during 1994, grew by an average of almost 10% annually during the 1996-2000 period and about 6.5% over 2001-2003. GDP growth in real terms has averaged about 7% for the 2004-2007 period and it is projected to reach about 8.5% in 2008. Agriculture remains a significant contributor to GDP, contributing about 38% of GDP and employing almost 90% of the workforce. More recently, a shift in the structure of the economy has emerged with industry and services increasing their share of GDP with strong growth averaging 11% and 9% respectively for the 2004-2007 period.

The major exports of Rwanda are coffee (which makes up more than 50 percent of the total export value), tea (which is considered to be amongst the best quality in the world), tin, cassiterite, wolframite and pyrethrum.

Prudent economic policies, liberalization and political stability have contributed to real economic growth in recent years and this is projected to continue, averaging 8% over the EDPRS period (ending 2012). A sticking point is the rise in inflation into double digits (15% end July 2008) largely driven by increases in food and oil prices as a result of global dynamics. Nevertheless, this inflationary pressure is expected to ease back into the single digits for the rest of the period on account of better agricultural yields and prudent monetary policy. The country has a free exchange rate regime and the Rwandan franc has remained relatively stable against the US dollar during the past few years.
4. Overview of Rwanda’s Financial Sector

Rwanda’s financial sector includes provident funds, six commercial banks, nine recognized microfinance institutions and cooperatives, one housing finance provider and one development bank. The sector is regulated by the National Bank of Rwanda (BNR). The Central Bank performs a supervisory role for commercial banks, the government, parastatals and internationally recognized government agencies. It is also responsible for the management of the country’s reserves, and the administration of exchange rates to smoothen out fluctuations and ensure stability of the economy.

Total assets held by the banking sector have gradually increased over the years to reach $407 million by September 2007.

The government of Rwanda has taken strides to strengthen the banking sector, and enhance the resilience of the financial system. The government is also seeking to promote the introduction of new financial products in the market – both by banks and non-bank financial institutions. Significant attention is being given to financial leasing as one of the alternative methods of financing asset acquisition.

5.1 Regulatory Framework

Leasing operations in Rwanda are regulated by a legal instrument enacted into law in 2005, the law no. 06/2005 of 03/06/2005 – Establishing Regulations and Conditions Governing Lease Operations.
According to article 15 of the leasing law, only a public limited company or a duly registered cooperative can operate as a lessor. There is no limitation on who can be a lessor provided the aforementioned criteria are met.

Regulation and supervision of leasing operations in Rwanda is vested in the National Bank of Rwanda, which is responsible for setting down, through instructions to lessors, the regulations and conditions for their licensing and operations. The central bank is currently in the process of drawing up regulations to this effect. Currently, there are no licensing requirements for non-bank lessors, although banks that provide leasing are already regulated through the normal banking supervision regulations. There are no minimum capital requirements for leasing, which implies that stand-alone leasing companies and microfinance institutions can start leasing operations without any impediments.

5.2 Tax Framework

The laws governing taxation in Rwanda include the income tax law, the law on taxation procedures, the investment code, customs law and VAT law. All these laws have been reviewed extensively over the last few years.

Under Rwanda’s current accounting framework, leasing transactions are not recognized and thus lessors such as banks, which have to comply with international financial reporting standards, are forced to account differently for tax purposes and for bank compliance on leasing transactions.

Unlike other forms of financing such as loans, there is a general lack of specific tax provisions relating to leasing operations, which places financial leasing at a comparative cost disadvantage compared to other forms of financing. Rwanda’s tax laws have undergone review over the last six years with the most recent coming in 2006. These included the income tax law, the taxation procedures law, the investment code and the customs law. A study by Ernst and Young on the effect of tax and accounting environment on leasing in Rwanda found that there is a general lack of specific treatment of leasing transactions.

The following section describes the treatment of leasing under the different taxes.

5.2.1 Profit tax

All parties to a leasing transaction are liable to pay corporate tax, and to comply fully with the requirements of the Rwanda Income Tax Law (N° 16/2005 of 18 August 2005). With respect to profit tax, unlike other countries, where a distinction is made between finance and operating leases, this is not the case for Rwanda. Thus under Rwanda’s tax regime, the rules of fixed assets capitalization, depreciation and or wear and tear deductions only cater for an operating lease courtesy of article 24 of the income tax law.
that allows only the owner of the assets to claim depreciation deductions. (This limits the parties’ choice of recording a leased asset in either of the parties’ books of accounts) clarification: if owner of the assets is allowed depreciation deductions why not have the asset in his books or is this in reference to a financial lease.

Looked at from the periphery, the current income tax law may look basic and straightforward where the lessee can reduce his taxable income by the amount of lease payments by treating the payments as operating expenditure which qualifies for deduction under article 21 of the Rwandan income tax law to the extent that the payments meet the following requirements:

a) To be incurred for the direct purpose of, and in the normal course of the business;
b) To correspond to a real expense and that is substantiated with proper documents;
c) To lead to a decrease in the net assets of the business and;
d) To be used for activities related to the tax period in which they are incurred.

The lessor on the other hand can capitalize the leased assets and claim depreciation deductions allowed under article 24 of the income tax law up to the limits set therein.

A keener look at the tax law, however, will indicate that there exists substantial grey area on the tax treatment of overheads incurred with respect to a leased asset.

Such overheads include maintenance and insurance of the leased asset which are legal obligations of the lessee under article 10 of the Rwandan leasing law. Whereas such overheads may be seen to fulfill most of the requirements of article 21 above, the problem may arise under the ‘substantiation with proper documents’ requirement. An example of a potential conflict of interpretation would be insurance of a leased motor vehicle. Insurance of a vehicle to which the lessee, a taxpayer in this case, has no title would most likely be open to diverse interpretation bordering on the disallowal of such expenses on the basis that the taxpayer had no business incurring expenses on assets he does not own.

Other tax jurisdictions have removed this ambiguity by making specific provisions for the deduction of such overheads. For example, Section 15 (t) of the Kenyan Income Tax Act (CAP 470 of the laws of Kenya) explicitly allows the deduction of expenditure incurred by a lessee in the case of a lease or similar transaction in accordance with leasing rules issued under the act.

To avoid doubt and apply the requirements of the Rwanda leasing law with respect to maintenance and insurance of a leased asset, clarity should be provided in the tax law in connection with overheads incurred by the lessee on account of a leased asset.
5.2.2 Depreciation of Leased Assets

Of significant importance to the lessor are the depreciation periods for assets. There are currently no distinct depreciation rates for leasing. Leased assets are subject to the following general depreciation rates.

Table 1: Asset Depreciation Rates in Rwanda

<table>
<thead>
<tr>
<th>PARTICULARS OF ASSET</th>
<th>RATE OF DEPRECIATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Intangible assets</td>
<td>10 percent</td>
</tr>
<tr>
<td>2. Buildings and incorporated machinery and equipment</td>
<td>5 percent</td>
</tr>
<tr>
<td>3. Computers, accessories, ICT/data equipment</td>
<td>50 percent</td>
</tr>
<tr>
<td>4. All other assets</td>
<td>25 percent</td>
</tr>
</tbody>
</table>

The above rates mean that buildings will be depreciated for a period of twenty years, intangible assets, ten years, computers and ICT related assets two years and all other assets, four years. In addition, registered investors are granted an investment allowance (by way of accelerated depreciation) of 40 percent of the cost of assets except vehicles of less than eight persons carrying capacity in the first year of the assets purchase or usage.

Depreciation periods have to be realistic to spur interest and growth of the leasing industry. For example, investment in a fleet of motor vehicles for lease cannot be seen to be attractive currently owing to the exclusion of motor vehicles, of less than eight persons’ carrying capacity, from qualifying for investment allowances allowed under article 26 of the income tax law. Similarly, the depreciation rates allowed for tax purposes are quite low, other than for ICT equipment, necessitating depreciation over a longer period than most lease durations. For example to depreciate a production building over 20 years, when after 10 years a new building is necessary to house a new form of production is not encouraging to would be investors in that key sector. Other emerging economies have used depreciation as a way of encouraging investment and investment in leasing can be expected to increase if the depreciation periods are shortened..

5.2.3 Value Added Tax

Article 3 of the VAT law (law number 06/2001 of 20 January 2001) defines a taxable service as anything which is not a supply of goods but is done for a consideration including lease, hire, assignment or surrender of any right or interest.

Leasing transactions are accorded no distinct treatment from other taxable services under the VAT law and are thus subject to 18 percent VAT without distinction. There is a disparity in the treatment of finance leases versus other forms of financing, more specifically bank loans. Currently, lease rentals are subject to 18 percent VAT while bank loan interest payments are VAT exempt under articles 86 (7) and 79 of the VAT law and the ministerial order on the application
of the same law respectively. Whereas VAT on lease rentals may be claimed as input tax under article 41 of the VAT law and thereby lessen the burden on the lessees, the same cannot be said to be certain for VAT on overheads, especially insurance, for reasons of asset ownership that are not clearly articulated in the law.

Another apparent mismatch is the general treatment of all leasing transactions as taxable supplies without regard to the object of leasing. For example, the supply of agricultural equipment is an exempt supply for VAT purposes; the lease of the same is not.

For lessors who are banks or financial institutions, their concern is the fact that VAT on the acquisition of the asset cannot be deducted as input tax fully on account of the apportionment rules imposed by the VAT regulations. The apportionment rules require suppliers of taxable services dealing in both taxable and exempt goods and or services to claim only apportion of input tax attributable to the portion of their taxable supplies. Most banks and financial institutions that have entered the leasing market are currently doing so through a division or department under their legal personality as banks or financial institutions and yet the bulk of their services are exempt from VAT. This would mean that the input VAT legally claimable by the banks and financial institutions is only the portion related to the smaller portion of the taxable supplies (including leasing transactions) compared to the overall services provided by them. It is also not clear whether relief from VAT on importations otherwise available through investment incentives is also applicable to all assets for lease since some of the
assets may not qualify as capital goods. Consideration may be made to allow claim of input tax on acquisition by lessor since the acquisition is made for purposes of making a taxable supply in the ordinary course of business of the lessor.

5.2.4 Property Tax

In Rwanda, property tax is currently chargeable on motor vehicles, boats, motor cycles and buildings. The tax is payable by the owner of the asset and it is a fully deductible expense for the owner. The tax rate, with respect to motor vehicles, boats and motor cycles, depends on their horse power while the rate with respect to buildings is determined by local decentralized administrative councils depending on their location.

The impact of property tax on leasing transactions is, at most, minimal as Rwanda has one of the lowest property tax rates in the region.

5.2.5 Import Duties

Leasing assets are subject to the same import duties as other any assets. Article 182 of the customs law lists plant and machinery as goods qualifying for the relief from duty while paragraph 4 of annex 1 to the investment code includes specialty vehicles including hotel shuttles and refrigerated vehicles on a list of goods exempt from duty upon importation by a registered investor.

However, there is a concern that the lack of specific mention of the treatment of goods destined for leasing may lead to diverse interpretation.

5.2.5.1 Temporary Importation of Leased Assets

Article 161 of the customs law allows temporary importation of goods into Rwandan territory. Leasing transactions, especially cross border leasing, may take advantage of this relief. The customs law however limits such temporary importation to six months except goods covered by specific conventions. This would be a short period for goods imported for leasing but ministerial orders provide for extensions upon justification. The fact that the law allows avenues for longer periods is indicative that specific conditions for leasing can be made without creating undesired precedents or inequity in the temporary importation customs regime.

5.2.5.2 Taxation of Cross Border Lease Transactions

Certain lease transactions may, of necessity, be of a scale too onerous for the in-country operators to finance. Need would therefore arise for cross border financiers to be involved in the transactions. Under the current tax regime, such transactions would be faced with a multitude of challenges including the
tax complicity of non-residency for the cross border lessors, import formalities complicities including the charge to withholding tax at five percent. VAT registration requirements for the lessors and reverse charge implications to the lessees in default of lessors’ registration.

With respect to the importation of goods for leasing by cross border lessors, complications would arise concerning the status of the importer. For importation purposes, importers are required to possess a unique Personal Identification Number (PIN) issued by Rwanda Revenue Authority. For corporate entities, an application for the PIN must be accompanied with the entity’s certificate of incorporation which is issued after a company fulfils all formalities for registration in Rwanda. This would cause a considerable constraint on cross border lessors.

For non-residency tax complicities, article 54 of the tax procedures law (law number 25/2005 of 04 December 2005) obliges non resident persons intending to exercise a taxable activity in Rwanda, with out an agent, to provide guarantees to the Commissioner General of Rwanda Revenue Authority that the person would comply with all tax laws and pay applicable taxes. Upon satisfaction that the guarantee is adequate, the Commissioner General would then issue the person with a certificate allowing him to exercise the taxable activities. In addition, some assets leased by cross border lessors may create a permanent establishment for the lessor in Rwanda in accordance with article 5 of the income tax law. For example, a factory, workshop, building or a place where assembly works are carried out would automatically create a permanent establishment for the owner of the assets which would make the owner liable to Rwandan income tax. This may not be very conducive in attracting cross border leasing deals especially from big players who are normally averse to creating permanent establishments in most countries.

The other challenge related to non-residency complicities for cross border leasing transactions is the issue of withholding tax of 5% on importation that is applicable to all imports except those whose importer holds a tax clearance certificate from Rwanda Revenue Authority. The tax clearance is issued to taxpayers who file their returns on time and are regular in their tax payments. Non-resident entities would not qualify for the certificate under the current conditions.

With respect to VAT, the tax procedures law requires any person dealing in taxable supplies to register for VAT if the person’s annual turnover is equal to or more than twenty million francs. All cross border lease transactions would give rise to the required turnover creating registration requirement complicities. On the other hand, in default of registration by the lessor, the transaction would be considered as an importation of service under article 29 of the VAT law to which reverse charge VAT would apply to be accounted for by the lessee. This would in it self create input tax claim complications on account of
the fact that input tax on reverse charge can only be claimed to the extent that the service giving rise to the reverse charge cannot be obtained in Rwanda.

5.2.6 Capital Gains Tax

Rwandan tax law does not impose distinct capital gains tax. Gains derived from the disposal of business assets are aggregated with other income and are taxed at the normal corporate tax rates. Entities are allowed to account for asset disposal proceeds by recognizing a gain or loss. A gain on disposal is recognized as income and taxed accordingly while a loss is recognized as an expense that reduces taxable income for the period of disposal as long as the disposal transaction has been concluded at arm’s length.

5.2.7 Withholding Tax

The absence of specific provisions for leasing in Rwandan accounting and tax laws and regulations means that leasing transactions are treated the same as any other transaction. The effect of this is that leasing operations are subject to withholding tax to its full extent. This is made more complicated by the ambiguity inherent in the current tax law provisions on withholding tax.

Article 51 of the Rwandan income tax law imposes withholding tax at fifteen (15 percent) percent on the following payments made by resident individuals or resident entities including tax-exempt entities: dividends, except inter company dividends attributable to resident companies, interest, royalties, service fees including management and technical service fees, performance payments made to an artist, a musician or an athlete and lottery and other gambling proceeds.
Whereas the law is clear enough with respect to management and technical fees, of significant concern to the taxpaying public is the use of the word ‘service fee’ in its most general form especially with respect to resident service providers. It is hard to practically determine what constitutes a ‘service fee’ and what does not for withholding tax purposes. Applying the tax to any ‘service fee’ would mean that the entire Rwandan service industry, including leasing, is run on withholding at 15 percent which is more than double the economy’s profit margin average. The legal provisions on this aspect are also contradictory across the three official languages used in Rwanda. Whereas the English and Kinyarwanda versions of the law levy the tax on “service fees including management and technical fees”, the French version seems to levy the same on commissions, technical and management fees through the words “les commissions dont les frais de services techniques et de gestion”. To the extent that leasing transactions are considered as service transactions, they will be caught into this ambiguity and contradictions in relation to withholding tax.

A 5% withholding tax on importation of goods is imposed on leasing but the effect on the importer is neutral since this is an advance tax that is offset against an entity’s final tax liability upon filing of the annual corporation tax return.
6. Performance of the Leasing Sector (June 2008)

6.1 Market Players

By June 2008 there were seven financial institutions providing leasing finance in Rwanda: Commercial Bank of Rwanda (BCR) and FINA Bank, were the pioneers of leasing in Rwanda beginning their leasing facilities in February 2006.

<table>
<thead>
<tr>
<th>BANK OFFERING LEASING</th>
<th>SHAREHOLDERS</th>
<th>YEAR INCORPORATED</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. FINA Bank</td>
<td>• FINA Kenya - 54.55 percent&lt;br&gt;• Enterprise Holdings Botswana limited 27.27 percent&lt;br&gt;• Rwanda Government 18.18 percent</td>
<td>2004</td>
</tr>
<tr>
<td>2. Commercial Bank of Rwanda</td>
<td>• Actis – 80 percent&lt;br&gt;• Rwanda Government and Private investors – 20 percent</td>
<td>2004</td>
</tr>
<tr>
<td>3. Development Bank of Rwanda</td>
<td>• Government of Rwanda, local public institutions, international development financial institutions, and the private sector</td>
<td>1967</td>
</tr>
<tr>
<td>5. Cogebank</td>
<td>• Private Investors</td>
<td>1999</td>
</tr>
<tr>
<td>6. Ecobank</td>
<td>• A conglomerate of private companies</td>
<td>2007</td>
</tr>
</tbody>
</table>
6.2 Leasing Volumes


In 2007, Cogebanque and Bancor entered the sector to offer leasing increasing transactions to a total of 164 leases with a value of over US$ 16 million.

By June 2008 the leasing transactions were over US$ 20 million.

6.3 Leasing Products

Currently all the practitioners do the traditional finance leasing with only 1% operating leases. The only operating lease deal transacted during the surveyed period was done by BCR bank. The lease included a buy back clause as operating leases are still not a favorite with the option to buy at the end of lease not a characteristic of this type of lease.
6.4 Types of assets financed through leasing

Below is a chart outlining the choice of equipment leased. A large percentage of the leases are for vehicles. This would be an obvious choice as the secondary market for vehicles is thriving.

Types of assets financed

- 65% Vehicles
- 7% Plant and Machinery
- 28% Other
6.5 Average Lease Duration

The average lease period in Rwanda is three years. The banks have found this period most comfortable for the lessee to pay back according to their cash flow. This works for the lessor as it minimizes the impairment of the leased assets over the lease period.

6.6 Average Lease Size

The chart below gives an idea of the lease sizes frequently written. Most leases range from $5,000 to $150,000.
6.7 Sector Distribution of Leases

Leasing providers do not apply uniform definitions to sectors, which creates a problem in aggregating lease volumes by sector. The classifications below are based on the sector in which the leased asset was used. For example, a distribution truck in an agriculture business is classified as under the agriculture sector.

The table below breaks down current leasing activity by sector. (consider changing the diagrams as mentioned above)

The bulk of leasing activity is in transport and distribution, accounting for US$ 4.3 million of the total US$ 6.9 million actually disbursed from June 2006 to June 2007. Currently, the two banks providing leasing services have a larger portfolio for business vehicles and trucks on lease than on the regular loan portfolio showing great potential for growth in leasing in Rwanda.
6.8 Regional Coverage

Ninety percent of leases financed are in the Kigali area. The remaining 10 percent are distributed between the remaining provinces mainly with busy border towns like the western province, a hotspot of trade between Rwanda and the Democratic Republic of Congo (DRC), followed by the northern province on the border with Uganda.
7. Recommendations for Developing Leasing in Rwanda

7.1 Market Prospects

The leasing sector has shown strong growth during the months surveyed. The sector can look forward to even greater growth in the future as there is a potentially large untapped market in small and medium businesses. The majority of lessors currently do most of their business with large enterprises, which tend to have access to collateral in the form of assets or other security. The lessors would have to adapt their systems to conclude leasing agreements with small and medium business as these will invariably be unable to provide any form of collateral, even the minimum 30 percent value of the equipment that is often required of large business entities. This makes leasing inaccessible and less attractive to many of the SMEs. Corporate and SME borrowing is presently limited to very few businesses with strong balance sheets and reliable credit histories. It is almost impossible for a start-up enterprise to raise funding through the conventional banking system hence the importance of introducing leasing to more banks and financial institutions.

The industry faces a number of challenges, such as difficulties accessing long-term financing, which is a major issue that constrains the expansion capacity of existing leasing providers. It would be beneficial for the leasing sector to establish a leasing association that would engage with decision-makers in order to ensure efficient and effective operation within the sector and encourage growth and development in the broader business environment as well as participate in policy making within the sector.

The widespread short term lending structure is one of the variants that limit banks to less than 100 percent lease financing. Longer term financing arrangements between financial institutions and lessees would reduce the pressure on lessee clients and encourage potential lessors to enter the market.

A number of new players are poised to enter the market, which bodes well for the future of the sector. Even with the promise of more access to leasing for the general population, there are many challenges which must be addressed by the sector if it is to be successful.

It is imperative that the regulatory and tax requirements and the accounting environment relating to leasing be simplified in order to attract lessors to the leasing sector.
8. Recommendations

8.1 Regulatory Environment

There are various views on whether Rwanda needs a law on leasing. Some countries without any legislation have very successful leasing operations, while others with existing leasing legislation have not seen any growth.

Evidence suggests that the existence of a leasing law in itself does not guarantee sector development, more so if the law is inadequate and does not match global best practices. In this respect, aspects of the current Rwanda Leasing Law need to be revisited in order to improve the prospects for leasing development, and attract more local and international players.

In addition to reviewing the leasing law, there is a need to ensure consistency and cohesion among the leasing law and other laws that could impact on the leasing law. It is also important that once the law is in place, efforts are made to educate key stakeholders on the implications of the law.

The following sections describe some of the proposed recommendations on the existing regulatory framework for leasing in Rwanda.

8.1.1 Legal Definition of a Lease

The current definition of a lease under article one of the Leasing Law should be revised to remove the phrase “…rents a property” and substitute it with “…allows another to use an asset” to make it more inclusive. Similarly, the conclusion of this provision should read “without necessarily assuming ownership of an asset.”

Secondly, the law does not distinguish between finance and operating leases. This distinction is important because operating leases are similar to normal rentals, whereas finance leases present special features such as the recognition of the “three-party” structure – the lessor, lessee and supplier.

Lastly, a distinction needs to be drawn between domestic and international finance leases.

8.1.2 Leased Assets

Article 2 of the Leasing Law lists assets that can be leased. This list is limited and should be expanded to allow for any type of asset to be leased.

It is recommended that the list of leased assets includes all tangible and intangible moveable and immovable non-consumable property, except for such property or goods that are illegal in Rwanda or are subject to restrictions by other laws.

8.1.3 Defining the parties to a lease

Under the current Leasing Law, there are two parties to a lease – the lessor and the lessee. The law provides that the lessor has to be a corporate entity. It is recommended that the law be refined to specify that the corporate entity referred to herein must be in Rwanda to avoid any misinterpretation. It should also be clarified that the lessee can be either an individual or a corporate entity.
Furthermore, the law should be amended to create a “three party” structure, with the supplier as party to the contract, alongside the lessor and lessee.

**8.1.4 Rights, responsibilities and allocation of risks among parties**

Typically, a lease transaction involves three parties – the lessee, lessor and supplier. The rights of these three parties are not adequately provided for in the current Rwandan Leasing Law, and this is likely to cause disputes as the industry grows. The law needs to clearly establish the rights and liabilities of the parties to a leasing transaction.

**8.1.5 Rights, obligations of a lessor**

- The lessor should have the right of ownership to the leased asset and the ability to enforce such right in case of default by the lessee
- Article 9 of the Law should be amended to clearly apportion third party liability in respect of the leased asset. Currently, the Law provides that the lessor and the lessee are jointly liable. It is recommended that the lessor’s liability be limited only to damage resulting from their direct acts or omissions. The Law needs to recognize the fact that the lessor owns the asset, but it is the lessee who uses it, and should thus be liable for third party damage.
- The lessor should not be liable for equipment defects as their role is purely acting as a financial intermediary
- The lessor ought to have superior rights in cases of lessee bankruptcy. There is need for clarity on third party interests in leased assets because the current legal framework does not clarify 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 all parties to a lease.
- The lessor should be given the right of assigning their rights to third parties without requiring the consent of the lessee, provided prior notice has been served.

**8.1.6 Rights and obligations of a lessee**

- The lessee must have the right to reject equipment that is defective or is not what was ordered. This right is not provided for in the Rwandan Leasing Law
- The lessee ought to hold the right of direct claim against the supplier for defects, but this is not provided for in the current law.
- There should be a legal imposition on the lessee of the absolute duty to pay the rent promptly after acceptance of a lease. The law needs to provide ultimate irrevocable obligation of the lessee to pay lease installments upon acceptance of a leased asset. The so called “hell or high water” clause – “i.e. in case of damage, wreck, theft of the leased asset or impossibility to use the leased asset or loss of its function or in cases when by virtue of circumstances for which the lessee was not responsible, the leased asset becomes unusable…”
shall not relieve the lessee from its obligations under the lease agreement and shall not result in premature termination of the lease agreement at the lessee’s demand, unless otherwise stated in the lease agreement.

- The risk of loss should be borne by the lessee.

- Article 5 and 7 of the Leasing Law are similar and should be harmonized as they address a very pertinent issue of the inability of the lessee to assign or sublease without prior consent of the lessor.

- Article 6 of the Rwandan Leasing Law clearly imposes the duty of proper care for the leased asset.

- The Law in Rwanda does not provide for the lessee having an absolute right of quiet possession over the leased asset provided that all the payments are paid and all other conditions of the lease agreement have been fulfilled. If the leased asset has any legal defects and/or there are third parties holding title to the leased asset and disturb quiet possession of the lessee, the lessee should have the right to terminate the lease agreement and the lessor should be held liable for any losses incurred by the lessee.

**8.1.7 Rights and obligations of a supplier**

As mentioned above, the supplier should be made a party to the lease. The supplier should owe the same duties to the lessee as they do to the lessor under the sale agreement. As such, it is the supplier, not the lessor, who should be responsible for material defects of the leased asset. The law should provide for specific regulation obliging the lessor to inform the supplier about the leasing contract. The asset supply contract should also become part of the leasing transaction, and it should impose liability on the supplier for material defect of the asset for protection of the lessee.

**8.1.8 Enforcement of lease contracts**

The current law does not provide for any repossession mechanism. It is critical that the law provides expedient repossession measures and efficient mechanisms for enforcement of lease contractual terms between parties. This is necessary to encourage investment in the sector as investors need to feel comfortable that they can enforce their rights through legal means.

**8.1.9 Third party liability arising from use of leased assets**

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

**8.1.10 Termination of lease agreements**

The law in Rwanda does not clearly articulate specific cases when termination is lawful as well as the specific effects that are caused by such termination, which have to be clearly specified.
8.1.11 Registration of leasing contracts

Under article 19 of the Leasing Law, where the lease operations involve immovable property, the registration should be carried out by the registrar of land title deeds.

Article 16 of the current Leasing Law places the registration duty under the provincial and city of Kigali courts and provides that a model lease register and fees for registration be determined by the Minister of Justice having justice in his or her attributions. To date no model fee structure has been determined by the Minister and therefore no lease is registered in Rwanda.

However, there is no registry of movable assets and asset registration for moveable assets is currently only performed through registration of collateral contracts.

Although an asset registry law was recently passed in Rwanda, it is a general law for the registration of all assets, and not specific to leasing. The law still awaits gazetting for legal effect. It is proposed that the leasing law be amended to provide for a lease registry for moveable assets to operate under the general asset registry law. Registration of leasing contracts will go a long way to protect the interests of lessors as this will serve as sufficient notice to third parties of a lien on the asset.

8.2 Recommendations on Tax Environment

The table below highlights the most critical areas that need to be addressed to support the development of the leasing sector and more specifically tax provisions that should be amended to facilitate leasing.

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<thead>
<tr>
<th>NO.</th>
<th>ELEMENT</th>
<th>CURRENT STATUS</th>
<th>EFFECT ON LEASING</th>
<th>RECOMMENDATIONS</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Accounting for Leases</td>
<td>The current accounting framework obtaining in Rwanda is a hybrid consisting of the National Accounting Plan, does not recognize leasing transactions in contrast with the elaborate treatment accorded to leasing under the International Financial Reporting Standards.</td>
<td>Parties to a leasing transaction in Rwanda are faced with a difficult situation where, on one hand, some of them like financial institutions are required to comply with IFRS by the central bank, while on the other; they are obliged to follow the National Accounting Plan for tax purposes.</td>
<td>Consideration should be given to the adoption of IFRS across the entire economy soon than later. Moreover, with the country's respectable success in attracting foreign investments, IFRS will be reporting framework required by most investors</td>
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<tr>
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<td>2</td>
<td>Taxation of Leases-General</td>
<td>There is a general lack of specific tax provisions for leases in the various tax laws.</td>
<td>This state of affairs does not help in instantiating and structuring leasing transactions in a way that is clear, consistent and compliant with the tax rules and regulations while at the same time encouraging the growth of the leasing industry.</td>
<td>Given the crucial role that leasing plays in economic empowerment, especially in the Small and Medium Enterprises Sector, a case should be made to introduce leasing ‘recognizing clauses’ across the existing tax laws to remove the glaring ambiguity that may affect the otherwise crucial driver in the economy.</td>
</tr>
<tr>
<td>3</td>
<td>Profit Tax</td>
<td>Wear and Tear/Depreciation/Amortization—Allowed only for the owner of the assets regardless of the type of lease.</td>
<td>- This makes the categories of leasing—finance vis-à-vis operating and their tested objectives not applicable from a tax perspective.</td>
<td>- Consideration should be given to allowing parties to a lease transaction freedom to agree on the treatment of the transaction in their respective books of account.</td>
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<td>Depreciation Rates—the allowed rates are low (as low as 5% for buildings) leading to a longer period (20 years) of depreciation of the asset than its productive period.</td>
<td>- This does not make certain assets, for instance buildings, conducive for leasing since the periods of depreciation are far longer than the periods when the assets are competitively required for leasing due to the current pace of technological advancements.</td>
<td>- A case needs to be made for assets specifically held for leasing to be depreciated for a period equal to their lease period.</td>
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<td>Investment Allowance—The investment allowance granted by way of accelerated depreciation of 40-50% is not allowed on vehicles of less than 8 persons carrying capacity.</td>
<td>- This makes leasing transactions involving trucks and other non passenger carrying vehicles not illegible for the investment incentive.</td>
<td>- A case needs to be made for this seemingly inconsistent treatment of business assets to be changed.</td>
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<td>Deductibility of expenses—Deduction of lease rentals from taxable income is not a problem but deduction of other incidental overheads like insurance and maintenance of the leased asset is. Due to the lack of a specific enabling clause in the tax law to the effect that expenses incurred with respect to a leased asset qualifies for deduction.</td>
<td>- The lack of a specific enabling clause in the tax law may make it difficult for the lessees to claim deduction of such overheads from their taxable income especially on assets subject to registration of legal ownership.</td>
<td>- Like other jurisdictions have done as highlighted elsewhere in this document, an enabling clause should be introduced in the tax law to allow lessees a deduction of overheads incurred with respect to leased asset since the asset is used wholly and exclusively for the production of the lessee’s income.</td>
</tr>
<tr>
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| 4   | VAT     | - Treatment of lease costs vis-à-vis Loan costs- leasing as a source of finance as bank loans. Interest on loans is exempt while Lease rentals (including the interest portion).  
-VAT status of the leased asset- Certain assets may be exempt from VAT on purchase or sale but not so under a lease transaction.  
- Input Tax Deductions by Lessors- Input tax on acquisition of assets, other than certain vehicles, is fully claimable by lessors whose business activities are wholly taxable. In instances where the lessor deals in taxable and exempt activities, especially banks and financial institutions, input tax must be apportioned in the ratio of taxable to exempt activities.  
- Input Tax Deductions by Lessees- VAT on lease rentals is claimable as input tax by the lessees, the same though cannot be said to be certain for VAT on overheads, especially insurance, for reasons of asset ownership that are not clearly articulated in the law. | - This unequal tax treatment of otherwise similar transactions puts leasing at a comparative cost disadvantage.  
- This puts the leasing of an asset at a cost disadvantage.  
- The apportionment rule means that if the lessor’s principle business is exempt from VAT, the way banks are, leasing would amount to a smaller component in the bank’s business, the bank is then required by the VAT legislation to claim only that portion of input tax related to its taxable business as percentage of its entire business in a given tax period.  
- This inevitably eats into the lessee’s already profit margin and ultimately impacts on the lease transaction’s intended objective. | - A case should be made to the competent authorities to exempt the interest element of the lease rentals from VAT.  
- A case should be made to the competent authorities to exempt from VAT lease rentals paid with respect to an asset that is in it self VAT exempt.  
- A case should be made to the competent authorities to exclude leasing transactions from the apportionment rule, failure of which banks and financial institutions may think unbundling their leasing operations from their traditional banking operations.  
- Consideration should be made for introduction of an enabling clause for deduction of input tax paid with respect to leased assets. |
9. Appendices

Regulator

National Bank of Rwanda
Paul VI Avenue, Kiyovu,
P.O. Box 531
Kigali, Rwanda
Telephone: (+250) 573197
Fax: (+250) 572551
Website: www.bnr.rw

Development Bank of Rwanda
Boulevard de la Révolution, Kiyovu
P.O. Box 1341
Kigali, Rwanda
Telephone: (+250) 575079
Fax: (+250) 573569
www.brd.com.rw

Leasing Providers

BCR Bank
11 Boulevard de la Révolution Kiyovu
P.O. Box 354
Kigali, Rwanda
Telephone: (+250) 515591
Fax: (+250) 573395
Website: www.bcr.co.rw

FINA Bank
20 Boulevard de la Révolution, Kiyovu
P.O. Box 331
Kigali, Rwanda
Telephone: (+250) 574456/8
Fax: (+250) 573486
Website: www.finabank.com

ECOBANK
Avenue de la Paix, Kiyovu
P.O. Box 3268
Kigali Rwanda
Telephone: (250) 503580
Fax: (+250) 501319

Vision Finance Company
P.O. Box 6893
Kigali Rwanda
Telephone: (+250) 501364

Bancor Bank (Now known as Access Bank as of January 2009)
UTC Building
P.O. Box 2059,
Kigali, Rwanda
Telephone (+250) 500091 / 575780
Compagnie Generale De Banque S.A. (Cogebank)
Centenary House
Avenue de la paix
P.O. Box 5230
Telephone: (+250) 597545/46
Fax: (+250) 503336
www.cogebank.com

Donor

Competitiveness and Enterprise
Development Project

Coordinator - Antoine Munyakazi – Juru
Address: P.O. Box 6671
Telephone: (+250) 5041177/8
Email: cedp@terracom.rw

The Team - IFC CEDP Rwanda Leasing
Development Program

Riadh Naouar (Program Manager)
Brian Kirungi (Task Team Leader/ legal Specialist)
Murekatete Rugege (Operations Analyst)
Belinda Mutesi (PR Specialist/Program Assistant)

Blvd. de la Révolution,
SORAS Building 4th floor
P.O. Box 609
Kigali, Rwanda
Telephone: (+250) 591350
Fax: (+250) 570405