

INTRODUCTION

This leaflet explains how V A T applies to leasing companies in the different situations obtaining in the industry. Some of the players in leasing consider their services to be related to the provision of credit and thus exempt. The leaflet also tries to identify the various supplies and explain the liability of such supplies for V A T purposes.

1.0 TYPES OF LEASES

The following are the most common types of leases available in Zambia:

- (i) Operating lease;
- (ii) Finance lease; and
- (iii) Sale and lease -back arrangement.

All these leases contain capital and financing elements both of which are standard rated for VAT purposes provided the subject of the lease constitutes a taxable supply. Where the subject the lease is merely advancement of finances (a loan), exemption applies.

1.1 OPERATING LEASE

This is a straight forward leasing arrangement, which involves hiring of a fixed asset such as machinery, equipment, motor vehicle etc. In this arrangement a client (lessee) hires the equipment from the leasing company (lessor) over the lease period which normally runs for one year and pays lease rentals to the lessor.

(i) Lease rental

This can be divided into two component parts; the capital component and finance charges.

1. (ii) Capital Component

This is the part of the lease rental that relates to the repayment of the cost of the asset.

(iii) Finance Charges

This is the part of the lease rental comprising other charges made by the leasing company such as credit charges, interest, fees and other financially related charges.

In an operating lease, the lessor lets the equipment and the lessee takes on lease the equipment for the period mutually agreed. During the lease period the lessor receives lease rentals, which attract VAT. Normally at the expiry of the lease period, the asset has a residual value which has not been exhausted by lease rentals. This residual value also attracts VAT when the asset is disposed of by the lessor. The Lessee can claim back the VAT incurred subject to normal input tax rules.

1.2 TAX POINT

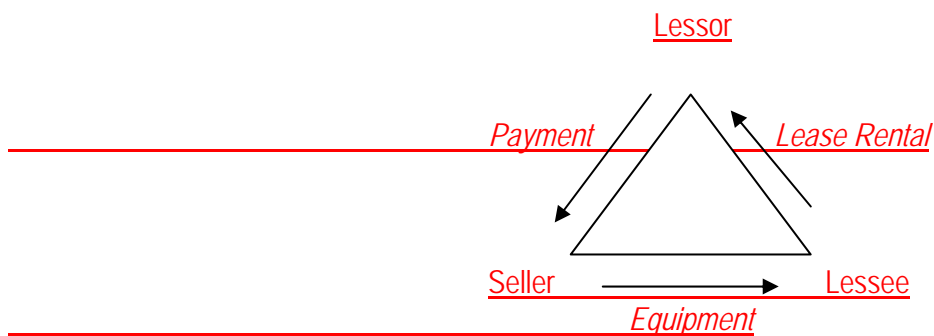
The time when leasing services are supplied for VAT purposes will be whichever is the earliest of the following times:

- (a) the time when payment of the lease rental is received from the lessee;
- (b) the time when the lessor issues a tax invoice;
or
- (c) the time when the leasing services are rendered and this condition will only be satisfied at the expiry of the lease period.

In practice, a lease rental will be received by the lessor before conditions band c can occur and this will be taken to be the tax point.

2.0 FINANCE LEASE

There are usually three players in a finance lease arrangement namely; the lessor, the lessee and the seller. The relationship between them can best be shown by the [triangle](#) below:



(i) Lessor

The lessor provides funds or rather pays for the equipment to the seller. The seller issues a tax invoice to the lessor who retains ownership or title to the asset. He can use this tax invoice to reclaim the input tax charged to him by the seller. The lessor charges VAT on the lease rentals paid by the lessee. Effective 9th of February 2007, the amount on which VAT is charged should not include the interest component

(ii) Seller

The Seller supplies the equipment to the lessee who has entered into a lease agreement with the lessor. At the same time he issues a tax invoice to the lessor.

(iii) Lessee

The lessee uses the asset during the lease period, whilst paying monthly lease rentals to the lessor. He also pays V A T on the capital component of the lease rental. The lessee is entitled to reclaim the VAT charged to him by the lessor if he is registered for V A T and the asset under lease is not motor car.

3.0 SALE AND LEASE BACK

In a sale and lease back arrangement, normally business does not have enough funds, such that if it buy equipment the business will run out of working capital. The business, therefore, decides to buy the equipment and sells it to the leasing company in order to raise working capital. But at the same time the business wants to continue using the equipment. The business then decide to lease the equipment from the leasing company and starts paying lease rentals over the lease period.

In this way, the business has the equipment and has raise working capital. In this arrangement, the lessor has to charge V A T on the capital component of the lease rental

3.1 LEASING OF MOTOR CARS

The general rule is that input tax on the supply or importation of motor cars is non-deductible. However leasing firms have been permitted by Statutory Instrument No 12 of 1998 to reclaim input tax on their purchases of motor cars meant for leasing. In all the above cases if the asset being leased is a motor car the lessor can reclaim input V A T charged to him by the supplier (seller) of the motor car. But this rule does not extend to the lessee. The lessee

being the end user cannot reclaim the input V A T charged to him by way of lease rentals on a motor car.

4.0 OWNERSHIP OF ASSET

In a lease agreement, the equipment, which is subject of a lease, legally belongs to the lessor. However, for all intent and purpose, the equipment will never be found on the premises of the lessor. In practice, the lessee enjoys the benefits of having the equipment and also assumes the risk of owning it.

Therefore, in normal accounting practice, the equipment is treated as if it were owned by the lessee and it is included on the lessee's balance sheet. What the lessor receives is a stream of cash flows for leasing the asset.

5.0 PARTIAL EXEMPTION

The leasing company is deemed to be involved in making one supply, that of leasing services which is taxable. Partial exemption rules do not apply to the industry. Therefore the lessor is entitled to reclaim the full input tax incurred on leased as well as non leased assets and other business expenses.

6.0 TERMINATION OF LEASE BY DEFAULT

In the event of default the lease shall be terminated at the option of the lessor and the lessee shall return the equipment which was subject of the lease to the lessor. Such transfer of equipment and the financial losses associated with such transfers will not constitute a supply for V A T purposes.

7.0 RECOVERY DISPOSALS

Disposal of equipment recovered from a defaulting lessee is a taxable supply and the lessor has to account for V A T on the disposal. The taxable value of such disposals is the sale proceeds. If the asset being disposed of is a motor car, normal V A T rules on resale of motor cars will apply.

8.0 MISCELLANEOUS

(i) Lease rental arrears

The lease rental arrears received by the lessor after termination of the lease will attract VAT. The lessor will account for V A T on such arrears.

V A T on expenses, incurred by the lessor in recovering as well as resale of the equipment such as legal expenses, expenses incurred in restoring the equipment to saleable condition etc. is reclaimable as input VAT.