3.0 SALE AND LEASE BACK

In a sale and lease back arrangement, normally a business does not have enough funds, such that if it buys the 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. However, at the same time, the business wants to continue using the equipment. The business then decides 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 raised working capital. In this arrangement, the lessor has to charge VAT on the capital component of the lease rental.

3.1 LEASING OF MOTOR VEHICLES

The general rule is that input tax on the supply or importation of motor vehicles is non-deductible. However, in accordance with regulation 6(4) of the Value Added Tax (General) Regulations, leasing firms are able to claim input tax on the purchases of motor vehicles meant for leasing. In all the above cases, if the asset being leased is a motor vehicle, the lessor can claim input VAT charged to him by the supplier or seller of the motor vehicle. But this rule does not extend to the lessee. The lessee being the end user cannot claim the input VAT charged to him by way of lease rentals on a motor vehicle.

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 intents and purposes, 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 claim 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 VAT purposes.

7.0 RECOVERY DISPOSALS

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

8.0 MISCELLANEOUS

Lease rental arrears will attract VAT whether or not they have been settled because the tax point would have been created by the service already provided. The lessor will account for VAT on such arrears.

VAT on expenses, incurred by the lessor in recovering as well as resale of the equipment such as legal expenses are claimable. Expenses incurred in restoring the equipment to saleable condition etc. are claimable as input VAT.

For more information contact:

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LEASING

INTRODUCTION

This leaflet explains how Value Added Tax (VAT) 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 identifies the various supplies in a lease transaction and explains the liability of such supplies for VAT purposes.

The provision of credit and the interest component of finance leases are exempt from VAT in accordance with Item 7 of the Value Added Tax Exemption Order. The following are, however, taxable:

(i) principal and other finance charges on finance leases
(ii) principal, interest and other finance charges charged on operating leases and
(iii) principal, interest and other finance charges charged by institutions engaged in hire purchase.

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 of the lease is merely an advancement of finances (a loan), an exemption applies.

1.1 OPERATING LEASE

This is a leasing arrangement, which involves hiring 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 a period shorter than the likely useful life of the asset and pays lease rentals to the lessor.

Lease rental can be divided into two components;

(i) Capital Component

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

(ii) Finance Charges

This part of the lease rental comprises 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 of 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:

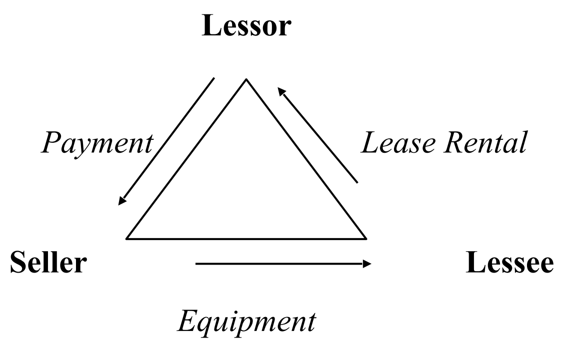
(a) the time when payment of the lease rental is received from the lessee
(b) the time when the lessor issues a tax invoice or
(c) the time when the leasing services are rendered and this condition will only be satisfied at the expiry of the lease period

In practice, the lessor will receive a lease rental before conditions (b) and (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 among them is illustrated in

Figure 1:



(i) Lessor

The lessor provides funds or pays the seller for the equipment. The seller issues a tax invoice to the lessor who retains ownership or title to the asset. The Lessor uses this tax invoice to claim the input tax charged to him by the seller. The lessor charges VAT on the lease rentals paid by the lessee.

(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 inclusive monthly lease rentals to the lessor. The lessee is entitled to claim the VAT charged to him by the lessor subject to normal input tax rules.