FINANCIAL LEASING IN RUSSIA
MARKET SURVEY 2001-2002

INTERNATIONAL FINANCE CORPORATION
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2002
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MARKET SURVEY 2001-2002

MOSCOW
2002

With financial support from the Canadian International Development Agency (CIDA)
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This survey and related research was carried out by experts from the IFC Leasing Development Group in Russia, and is the result of an analysis of the current situation on the Russian leasing market. Based on research on Russian leasing companies and their main counterparts, lessees and financial institutions, as well as an analysis of the macroeconomic situation and its influence on leasing, this review is intended to provide an overview of the prospects and difficulties faced in the development of the financial leasing market in Russia in 2001 and the first half of 2002.

The IFC Leasing Development Group (LDG) was launched in 1997 to cooperate with the Russian government and private sector players interested in leasing to create and develop favorable legal and economic conditions for the development of financial leasing in Russia. The LDG is primarily financed by the Canadian International Development Agency (CIDA). This report is the fourth market review published; the previous reports were published in 1998, 2000 and 2001.

Various methods of collecting information were used in the preparation of this report, including polling leasing companies by mail and in person, as well as by holding interviews with lessees and other market participants. We hope that the information presented in the report will allow market participants and interested investors to gain a better understanding of the current situation and possibilities of the Russian leasing market.

\[1\] At the time of publication, there are two regional projects working to develop leasing in Russia: The Urals Leasing Development Group, funded by the United Kingdom Department for International Development and the Northwest Russia Leasing Development Group, funded by the Ministry of Trade and Industry of Finland. Experts from these groups also contributed to research and data collection for this report.
LEASING MARKET:
MARKET OVERVIEW

Based on an analysis of the work of leasing companies (lessors), lessees and financial institutions, and also of the macroeconomic situation in the country, this report underlines current trends and peculiarities in the development of the Russian market for leasing.

Financial leasing is an important source of long and medium-term financing for companies in many countries, regardless of their size and production profile, allowing them to increase production and grow their fixed assets.

The current legal and regulatory base for leasing in Russia is reasonably well developed; the primary documents regulating leasing include the Russian Civil Code, the Federal Law “On Leasing” and the UNIDROIT Convention on international financial leasing. Over the past year, significant changes have taken place in the taxation system in Russia, including the adoption of Chapter 25 of the Tax Code. This chapter regulates corporate profit tax and maintains a favorable regime for taxation and, as a result, the economic advantage of leasing deals.

In 2001 and the first half of 2002, the Russian leasing sector continued to develop. An analysis of the portfolios of leasing companies indicates significant growth in the volume of leasing operations. According to our estimates, the size of the Russian leasing market in 2001, based on the cost of equipment, amounted to $1.7 billion (all dollar figures are U.S.).

Russian economic growth slowed in 2001. One of the factors hindering faster economic growth is the fact that productive equipment at Russian companies are old and worn out. Replacement of these assets is primarily financed from retained earnings due to a lack of access to borrowed funds. Although there has been an increase over the past year and a half in bank lending for the so-called “real sector of the economy,” banks are still not fulfilling their role as financial intermediaries.

Leasing, as an alternative financing mechanism, can play an major role in renewing fixed assets at industrial companies, allowing them to grow and increase their productivity.

The small business sector has been identified as a potential source of increased economic growth. Leasing is an effective mechanism for financing this sector, which the banking sector has traditionally passed over. According to our survey, leasing companies are indeed providing substantial funding to small and medium-sized enterprises. It is no longer the case that leasing companies connected to regional administrations, municipal banks, and federal and local agencies for the support of small and medium-sized businesses are most actively working with small businesses, as was the case in 1997-1999. As the results of our survey indicate, small and medium-sized businesses are clients for 78% of leasing companies. Despite the fact that companies work with a wide circle of clients and various
types of equipment, leasing companies have managed to develop a successful policy for minimizing the risk of the lessee not meeting his payment obligations.

Leasing helps equipment suppliers, both Russian and foreign, to sell their equipment to Russian companies which have insufficient capital to purchase capital goods. Suppliers may even be able to shoulder some of the risk connected with a leasing deal by providing the leasing company, for example, with a buy-back guarantee.

Our survey also indicates that leasing is currently one of the few sources of long-term and medium-term financing available to Russian companies. The leasing mechanism is attractive to the lessee because of its economic effectiveness, flexibility and accessibility in comparison with bank finance. While the current tax regime plays a role in the attractiveness of leasing, we consistently are told by lessees and others that flexibility, security and other operational aspects are at least as important.

As with any other financial deal, leasing is accompanied by a certain level of risk for each of the sides in the leasing agreement. Nevertheless, in Russia leasing, allows suppliers to increase their sales, provides lessees with a mechanism to acquire much-needed assets and stimulates the economy through capital investment.

In the near future, we expect Russia will see continued growth in leasing. In 2002, this growth should be most significant, as the risks involved with leasing have fallen significantly due to major legislative reform. In future years, growth of the leasing sector should be less rapid, although certain legislative, regulatory and market changes have the potential to give the sector a further boost.
LEASING MARKET: HISTORICAL PERSPECTIVE

LEASING: FIRST STEPS

Leasing first appeared in Russia in Soviet times. At that time, leasing was mainly used to acquire ships and planes. However, these deals were very few in number and were carried out by only a few organizations that worked in the area of international economic relations (Sovfrakht, Minmorflot and Sovtransavto). At the start of the 1990s, the first leasing companies started to appear in Russia, most of which were founded by commercial banks.

INITIAL INDUSTRY DEVELOPMENT

By the mid-1990s the Russian government, realizing the potential of leasing and its benefits for economic development in the country, passed a number of resolutions aimed at supporting the leasing sector. New companies appeared on the market founded by financial industrial groups. The main area of activity of these companies was the modernization of production capacities at companies within the group. Leasing companies were also set up in conjunction with municipal and regional authorities, which had access to financing from budget sources at concessional rates.

Two resolutions passed by the Russian government played an important role in the development of leasing. The first – resolution No. 1133 from November 1995 – stated that the lessee may expense leasing payments. The second – resolution No. 752 from June 1996 – allows for the application of accelerated depreciation. These resolutions, while important, did not resolve all the problems related to either taxation or the numerous other legal and accounting questions raised by leasing.

From the moment leasing appeared in Russia, indicators in the sector increased not only in relation to the number of leasing companies, but also in relation to the volume of leasing deals. In 1995, for example, the total volume of deals entered into by members of Rosleasing (the Russian Association of Leasing Companies, which represents only a subset of the market) amounted to 170 billion rubles ($42 million). The next year, this figure jumped to 670 billion rubles ($500 million). In 2002, four years after the financial crisis, the volume of deals had recovered to the level of $530 million.

THE FINANCIAL CRISIS IN 1998

The decline in the Russian financial sector that followed the crisis in August 1998 had a significant influence on the development of leasing in Russia. In particular, the crisis led to a sharp decline in long-term bank financing, and as a result, many leasing companies were forced to close. In addition, according to our estimates, the volume of leasing agreements fell from about $1.4 billion to a little over $400 million.
As a result of the crisis, companies that received loans to finance leasing deals in dollars and entered into deals in rubles, thereby taking on currency risks, suffered significantly. Attempts to hedge these risks were often unsuccessful.

However, according to interviews with lessors, we discovered that in cases where the currency risk was initially transferred to the lessee, leasing agreements entered into prior to the crisis were rarely broken. In the majority of cases, leasing companies accommodated lessees, reviewing payment schedules, staggering payments, etc. The policy of leasing companies after the crisis again confirmed that leasing is a flexible mechanism of financing that takes the interests of the lessee into consideration. On the part of lessees, companies in different industries were able to regain their pre-crisis pricing levels at very different rates. Companies whose prices were largely dictated by foreign producers were able to re-price relatively rapidly in dollar terms. For many leasing companies, allowing a short period for rescheduling was sufficient to allow the lessee to recover to the point where leasing payments could be serviced.

**POST CRISIS RECOVERY AND DEVELOPMENT (1999-2001)**

The establishment of new leasing companies continued in the post crisis period. In the year following the crisis, 317 companies received leasing licenses, or growth of 51% in nominal terms.²

Growth in the Russian economy has definitely had an influence on the leasing sector. The companies that benefited the most were those leasing companies with experienced and professional management that were independent from banks, had suffered as a result of the crisis and were willing to take on risk connected with leasing activity.

Banks were still unwilling to grant medium-term and short-term loans, and therefore leasing companies were forced to search for other sources of financing. In addition to expanding their funding base, leasing companies also expanded their client base and the range of equipment with which they worked. Leasing companies traditionally begin operations by providing finance for vehicles. As they develop and gain experience, they frequently move on to leasing more complicated equipment.

A significant part of the lease financing provided by independent leasing companies is aimed at small and medium-sized businesses – parts of the Russian economy that continue to have significant growth potential. In our opinion, this is an extremely positive trend for the Russian leasing sector.

**DEVELOPMENT OF THE LEASING SECTOR IN 2002-2003 (FORECAST)**

At the start of 2002 the leasing sector developed further, with significant growth visible in company operations. This was aided by several macroeconomic conditions. Economic growth continued, although more slowly than the previous year. Chapter 25 of the Tax

Code of the Russian Federation came into effect from the beginning of 2002, regulating corporate profit tax and retaining all the significant advantages of leasing. In addition, with the adoption of amendments to the Law on Leasing, which brought the law into line with the Russian Constitution and the Civil Code, risks connected with leasing deals were reduced. The reduction of risk in both taxation and other legal aspects removed the primary obstacles to the development of domestic leasing.

In early 2002, the volume of bank lending grew, increasing access to financing for leasing companies and other borrowers. In addition, in the years since the crisis, leasing companies have broadened their funding bases and established stable relations with suppliers (credits from suppliers are currently used by 32% of companies polled).

The decline in the growth rate of the Russian economy is a concern, and according to analysts’ forecasts, will come to 3.6% in 2002, and in 2003 – 3.4%-4.4%. To increase the growth rate, structural changes in the economy will be necessary as will replacement of fixed assets with more productive equipment (the average age of fixed assets in industry at the start of 2001 was just under 19 years).

Leasing, as an alternative financing mechanism, can play an important role in carrying out these strategic tasks: both the renewal of production assets at industrial companies and the development of small and medium-sized enterprises. As the information from our survey shows, the majority of leasing companies are working with production companies and small and medium-sized businesses, and offer a real, accessible means of acquiring productive assets.

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3 Forecast by German Gref reported by Interfax on May 15, 2002.
4 See Investment Market: Conditions in 2001 // Investment in Russia.
MACROECONOMIC OVERVIEW AND IMPACT ON LEASING IN 2001-2002

GDP GROWTH (1999-2002)

Since the crisis in 1998, the Russian economy has developed quite quickly. The GDP growth rate has declined gradually, however, and in 2001 came to 5.3%. This trend has not changed in the first half of 2002: GDP growth in April amounted to 3.7% compared with April last year and 0.7% compared with the previous month.\(^5\) GDP continues to grow, but at a noticeably slower pace. To understand the reasons for the slowdown in growth rates, it is necessary to consider what factors created the basis for economic growth in 1999-2001.

Diagram 1: GDP Growth (%).

![Diagram 1: GDP Growth (%)](image)

Source: State Statistics Committee, Troika Dialog.

Sources of economic growth in 1999-2001

Economic growth since the crisis in 1998 can be conditionally divided into three periods. The first wave, from October 1998 to July 1999, was characterized by import replacement, growth in revenue at Russian companies and investment of company revenue in sales, and particularly in fixed capital; in other words, this first period of growth was primarily due to the devaluation of the ruble. The second wave was due to growth in oil prices – the main source of which was exports and consumer demand. The third wave (February-August 2001) was based on growth in revenue and domestic demand.

The peculiarity of economic growth in 1999 and 2001 was due to unutilized production capacity and excess (underemployed) labor on company payrolls, which meant it was

\(^5\) Information from an announcement by Economic Development and Trade Minister German Gref published by news agencies on May 28, 2002.
possible to expand production without acquiring new equipment or hiring additional workers. However, these growth reserves have already been exhausted.

**Economic growth continues, though growth reserves have already been exhausted**

**FORECASTS FOR RUSSIAN ECONOMIC GROWTH**

According to leading analysts, both Russian and foreign, further growth in the Russian economy will be defined by two main factors: internal – meaning reforms; and external – primarily world oil prices. The World Bank reported in May 2002 that, if economic conditions are favorable and reforms are carried out, Russia may achieve average annual growth rates of 5.2% in 2002-2010. However, to ensure this economic growth it is necessary for investment in fixed assets to increase 17% per annum, a very high growth rate. A more pessimistic scenario estimates growth rates at not more than 1.5% per annum.

**According to many analysts, economic growth will be bolstered by the development of the small business sector and increased investment.**

Russian experts consider that the economy has the possibility to increase growth, especially through small business and investment. It is also important to consider the possibility of growth in individual sectors of the economy, and not only export-oriented sectors, for example the agricultural sector. However, most studies of the economy and most experts agree that everything hinges on one fact: without structural changes in the economy, and without the development of the processing industry, further economic growth will be difficult.

**INVESTMENT**

Investment in fixed capital from all sources of financing in 2001 amounted to 1.6 trillion rubles, up 8.7%. Investment by sector has remained practically unchanged, and most is accounted for by the fuel industry, transport and residential utilities.

**Investment in equipment**

According to a poll of company managers carried out by the Association of Managers of Russia and the Kommersant publishing house, the level of wear and tear of fixed assets is one of the main obstacles to the development of business in Russia.

The development of the processing industry requires the acquisition of new equipment. However, at present most investment in equipment is used to acquire components (parts) for already existing production lines and complexes. Only 10%-15% of investment is used to build new production lines. As a result, companies are continuing to use obsolete technology which severely limits their ability to produce high-quality, competitive products.

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7 See Kommersant, No 108 from June 26, 2002.
Growth in the replacement of productive assets observed in 2000 was clearly insufficient to replace obsolete and worn out equipment. As a result, as can be seen in the table, by the start of 2001 38.2% of fixed assets was machinery and equipment installed over 20 years ago.

**Table 1: Age structure of production assets (machinery and equipment) in industry**

<table>
<thead>
<tr>
<th>Year</th>
<th>All equipment at the end of the year (%)</th>
<th>Age of equipment, years</th>
<th>Average age, years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Up to 5</td>
<td>6-10</td>
<td>11-15</td>
</tr>
<tr>
<td>1995</td>
<td>100.0</td>
<td>10.1%</td>
<td>29.8%</td>
</tr>
<tr>
<td>2000</td>
<td>100.0</td>
<td>4.7%</td>
<td>10.6%</td>
</tr>
</tbody>
</table>

*Source: Investment market: Conditions in 2001//Investment in Russia.*

**Sources of financing for internal investment**
Domestic investment is being held back by the lack of funds available for borrowing. Sources of financing for investment in fixed assets mainly consisted of owner’s capital (50.3%). The share of bank loans in the financing of investment in productive assets remains lower than in the post-crisis year of 1999 (4.2%), although it has increased from 2.9% in 2000 to 3.5% in 2001.

**Foreign investment**
The volume of foreign investment in Russia in 2001 increased 30% in comparison with 2000 to $14.3 billion.8

Priority sectors among foreign investors since 1998 have remained the same: most foreign investment in 2001 was in trade and catering (37.1%).

In the structure of foreign investment, a large part is accounted for by other investment (credits). Portfolio investment has seen substantial growth, amounting to $451 million (or 3.2% of total investment), and has the potential to grow significantly more.

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8 According to information from the Direct Investment Institute.
As can be seen in the chart, foreign direct investment (28%) predominates over portfolio investment (3%).

**Foreign direct investment**
Foreign direct investment is investment in companies with some degree of management influence or control of the company. In terms of the form of business ownership, foreign investors in Russia prefer to set up their own companies rather than entering into various types of civil-legal contracts (for example, commercial concession contracts, joint ventures, etc.).

Information on volumes of foreign direct investment provided by official Russian sources and foreign analysts do not coincide. According to estimates from the Russian Economic Development and Trade Ministry, the volume of foreign direct investment in 2001 totaled about $4.2 billion versus the Direct Investment Institute’s $3.9 billion estimate. The Economist sets the figure even lower, at $2.9 billion. In the end, the volume of foreign direct investment remains lower than in the pre-crisis period.
According to analysts, in 2001 Russian capital that had fled in earlier years began to return to Russia, which indicates an improvement in the economic situation in Russia.

**Situation with foreign investment at the start of 2002**

In May 2002, the State Statistics Committee published a report stating that the volume of foreign investment in the Russian economy in the first quarter of 2002 was up 39.4% over the previous year. However, the increase took place as a result of loans and portfolio investment, and the volume of foreign direct investment continued to fall for the fourth quarter running.

**Obstacles to foreign investment**

While the investment climate has improved in Russia, there are still many obstacles that need to be removed. These mainly involve the ineffective system for resolving disputes in the courts, weak support for ownership and creditors’ rights and the risk of changes in the political sphere.

Even a significant increase in foreign investment will not satisfy investment requirements in Russia, and as such, the demand for investment will have to be met by relying primarily upon internal resources.

At present, the problem remains that neither the capital markets nor the banking system are accumulating savings and transforming them into investment, that is, intermediating between the cash-heavy and those in need of investment funds. In addition, according to some analysts, only about a third of the total investment potential of the Russian economy is being realized. Two thirds of accumulated savings are lying idle or are taken abroad. The primary source of investment remains retained earnings and ‘own funds’ (capital) at over 50% of total investment. Without further reform of the banking and financial systems and structural changes in the economy major changes in the level of investments are unlikely.
Leasing as a mechanism for financing investment in production assets

Since the crisis in 1998, leasing has confirmed its advantage as an alternative means of financing the acquisition of production assets. In addition, banks sometimes prefer to finance the acquisition of production assets through leasing companies, as leasing deals have stronger guarantees (that is, outright ownership of the asset) than even secured or collateralized loans, a point which was repeatedly noted by banks polled. Foreign suppliers may also be interested in using leasing as a sales mechanism for its products. They may work with existing Russian leasing companies or set up their own leasing companies in Russia, as Caterpillar, Daimler Chrysler Service (debis), and Hewlett-Packard have all chosen to do.

SMALL BUSINESS

According to official information, the number of people employed in small business in 2001 fell slightly – information from the end of the third quarter 2001 shows a drop of 3.7%.\footnote{According to the Small Business Resource Center at the Russian Anti-monopoly and Entrepreneurship Ministry.} However, the number of people employed in small business has increased 300% over the past three years.\footnote{Speech by Alfa Bank President Pyotr Aven in the American Chamber of Commerce.} All figures on the SME sector are controversial, however, since the State Statistics Committee has considerably more difficulty compiling data on SMEs – particularly those with the status of ‘individual entrepreneurs.’

Small business development in Russia as compared to other countries.

Table 2: Age structure of production assets (machinery and equipment) in industry

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of small and medium-sized businesses (thousand)</th>
<th>Number of small and medium-sized businesses per 1,000 residents</th>
<th>Number employed in small and medium-sized businesses (million people)</th>
<th>Share of small and medium-sized businesses in overall employment (%)</th>
<th>Share of small and medium-sized businesses in GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
<td>15,770</td>
<td>45.0</td>
<td>68.0</td>
<td>72</td>
<td>63-67</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>19,300</td>
<td>74.2</td>
<td>70.2</td>
<td>54</td>
<td>50-52</td>
</tr>
<tr>
<td>Japan</td>
<td>6,450</td>
<td>49.6</td>
<td>39.5</td>
<td>78</td>
<td>52-55</td>
</tr>
<tr>
<td>Poland</td>
<td>1,726</td>
<td>18.3</td>
<td>7.1</td>
<td>63</td>
<td>48.1</td>
</tr>
<tr>
<td>Russia</td>
<td>891</td>
<td>6.1</td>
<td>6.5</td>
<td>10</td>
<td>10.2</td>
</tr>
</tbody>
</table>


The level of development of small business is clearly insufficient at present for this sector to become the main source of economic growth in the Russian economy. The main obsta-
cles encountered by representatives from small and medium-sized businesses in their activities include:\(^{11}\)

- the imperfect nature of the regulatory-legal base for administering small business on the part of the state, particularly the administrative burden and excessive regulation;
- the absence of effective financial-credit mechanisms and material support for the development of small business;
- an imperfect taxation system.

Despite the reforms announced by the Russian government, small business is still suffering from excess regulation and insufficient financing. The problem of corruption is a much larger one, but the burden of corruption and that of excessive regulation both weigh proportionally more heavily on SMEs. For financing, small businesses are often effectively forced to turn to ‘informal lending sources’, which can range from friends and families to loan sharks; rates can be much higher and legal protection non-existent.

**Role of leasing in the development of small business**

A total of 38\% of companies that participated in LDG’s survey work exclusively with small and medium-sized businesses and another 40\% work with companies of any size. Consequently, small companies are potential clients for 78\% of the leasing companies surveyed. For a variety of reasons, the survey sample is skewed towards those companies working with SMEs, but is still indicative of the fact that there are a significant number of leasing companies that work in this sector.

*Leasing is an effective mechanism of financing for small and medium-sized businesses - 78\% of leasing companies polled work with these businesses.*

Many small businesses that were turned down for leasing finance by banks have turned to leasing companies, with which they subsequently signed an agreement. After completing one deal, these companies often return to the leasing companies if they again need to acquire new equipment or transport vehicles. The leasing scheme allows a company to retain its working capital, which is a big advantage. In addition, in the long-term, successfully completed leasing deals will help small businesses to acquire a credit history, which they will need in the future when approaching banks. We have seen some evidence to suggest that SMEs that work with leasing companies begin to move out of the so-called ‘grey economy,’ because the possibility of receiving sufficiently flexible financing to meet their needs provides (perhaps for the first time) the incentive to regularize their tax and legal situation.

\(^{11}\) See materials from a working group of the Russian State Council Presidium on the support and development of small and mid-sized business.
The small business AOZT KOM began its activity in 1994. The company was involved in auto repairs and servicing of equipment using composite materials. In 1997, the company decided to become involved in freight transportation. Although AOZT KOM had some of its own funds to buy automobiles, management did not wish to utilize the company’s working capital. In its search for financing the company turned to the local administration to receive a bank credit, but this attempt was unsuccessful. Novgorod Leasing Company supplied KOM with real help and acquired and supplied the company with a Gazelle truck. Having tried out leasing with one vehicle, the company realized the advantages of leasing and decided to use this scheme to expand its fleet. Today, road transport is an independent area of the company’s activity representing 25% of the company’s overall profit.

In addition, the company decided to use leasing to acquire additional equipment, including an MK-15 polyurethane unit, which raised the quality of the company’s business.

In general, automobiles and equipment acquired by leasing allowed the company to cut costs, become more competitive and increase sales by 35%.

RUSSIAN BANKING SYSTEM IN 2001 – EARLY 2002

By the start of 2002, banks in Russia had largely overcome the 1998 crisis. According to “Expert” magazine, by end-2001 assets at operating banks in real terms amounted to 140% of the pre-crisis level, while capital in real terms exceeded 120% of the pre-crisis level. Revenues for the year will be at a record level, forecast to exceed 65 billion rubles. The last time this was observed was in the mid 1990s. Analysts also noted that the source of this revenue was no longer operations with government securities, but lending to the real sector of the economy.

The main source of bank revenue in 2001 was lending to the real sector of the economy.

The share of loans to the non-banking sector at the start of December, according to various sources, was 40% to 45% (this is the highest level since 1994), while the share of overdue loans remained the same.

The increase in lending is clearly demonstrated in the following chart based on information from the Central Bank. Loans to non-financial private companies and the public increased more than 40% over 14 months from 867.132 billion rubles in January 2001 to 1.444 trillion rubles (as of March 2002).
Diagram 4: Claims on non-financial private companies and the public (billion rubles)

We should note that the share of ruble lending in the overall portfolio of Russian banks increased from 64.5% at the start of 2001 to 68.1% by December 2001.

Most loans in 2001 were for periods of less than one year. The share of long-term credit investment fell to less than 5%. Some critics have commented that a significant portion of this 5% may represent loans that are technically in default and that have been rescheduled.

It is necessary to carefully consider the above information. As many analysts confirm, growth in lending mainly occurred due to the fast-growing Sberbank portfolio, which accounts for 25% of total assets in the banking sector and 75% of total retail deposits, although the latter share is slowly falling. In other large Russian banks, the share of loans in bank assets has done the opposite, falling during the same period. In addition, even if the share of lending in the portfolio of a commercial bank is high, most of it (up to 95%) is often accounted for by companies that are part of the same financial-industrial group. Banks frequently lend to companies in the “extractive” (natural resource) sectors or to companies involved in export operations. Russian banks often simply lack the desire, capacity and experience lending to Russian production companies, particularly non-related ones. Small regional banks are severely restricted in their lending by insufficient capital.

The Russian banking system is still not fulfilling the role of a financial intermediary
The insignificant role of banks in financing the Russian economy is also indicated by the fact that the share of bank loans in financing investment in fixed assets in 2001 was only 3.1% (in 1999 – 4.2% and in 1997 – 4.5%).

Despite positive changes in the banking sector, as noted earlier, the banking system in Russia is still not fulfilling its role as a financial intermediary, i.e. a system for allocating financial resources between sectors of the economy. There are several reasons for this:

- insufficient capitalization of banks;
- non-transparent financial reporting by companies;
- an ineffective (from a legal point of view) system for realizing collateralized rights.

**Insufficient capitalization of the banking system**

The volume of assets in the Russian banking sector is a little over $100 billion, which is insignificant by international standards. As of January 1, 2002, of 1,319 operating credit organizations, only 230 banks (17%) had capital of more than 5 million Euros. Another 171 banks (13%) were in the “transition zone,” corresponding to capital of 2.2 million Euros to 5.5 million Euros and the remaining banks, i.e. almost 79%, have capital of less than 2.2 million Euros.

**Reform of the banking system**

The ineffectiveness of the banking system means that concrete measures are required to reform this sector of the economy. In early 2001 the Russian government and the Central Bank confirmed a strategy for the medium-term development of the banking sector. The main areas of this banking reform will be:

- the switch to international accounting standards;
- the establishment of a funded private deposit guarantee scheme and more orderly liquidation of bankrupt banks;
- increasing the minimum size of charter capital to 5 million Euros and increasing capital sufficiency requirements to 10%;
- reducing the number of functioning commercial banks (by means of mergers, raising the minimum capital requirements, and limiting the number of banks allowed to take deposits from the public);
- withdrawal of the Central Bank from the capital of Vneshtorgbank and (eventually) Sberbank of Russia, although the latter is a tricky political issue;
- sale of state shares in the majority of the 400-plus banks in which the government indirectly or directly owns shares.

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13 According to information from the research department of The Economist magazine.
14 Beginning in 2007, this will be the minimum capital requirement for commercial banks.
Banks and leasing
Leasing can help banks to increase their share of long-term lending to the real sector. According to our survey, banks that establish leasing companies consider leasing to be a complementary instrument in their work (although some believe leasing competes directly with bank lending).

Leasing may help banks increase long-term lending to the real sector of the economy.

As seen in other countries (and as experience in Russia is beginning to show), many leasing companies that were originally established by banks eventually begin to provide leasing services independently of the founder bank and establish a different client base and different operating procedures. By expanding their client base and diversifying their funding, leasing companies become more independent from their founders and become general leasing companies. Leasing companies in Russia that were originally established by banks, for example, Baltic Leasing and Leasingbusiness, are confirming this trend by developing their activity independently.

A client chooses a form of financing – leasing or credit – based on economic calculations, risk characteristics, and services provided, and the client has the final word (according to banks polled). If a bank has a leasing company, it generally prefers to borrow for asset acquisition from the related leasing company. The fact that the leased asset during the entire period of the leasing agreement belongs to the leasing company is an additional guarantee for the bank. As a result, the amount of security required for the deal is reduced.

However, all of the above relates only to leasing companies founded by banks. In cases where banks use independent leasing companies, they relate to them as to any other borrower that applies to the bank to acquire equipment, although of course the leverage typical for leasing companies means that not all banks are comfortable lending to them. In this respect, Russian banks tend to be fairly conservative about lending to non-related leasing companies, as they generally lack the experience dealing with leasing companies.

FACTORS INHIBITING THE DEVELOPMENT OF LEASING SECTOR
Poor access to long-term lending
The development of leasing in Russia is being inhibited by several factors at a macroeconomic level, in particular, a lack of access to long-term financing. However, access can only be improved through improvements in the banking system.

Protection of property rights
Leasing companies are still experiencing difficulties repossessing equipment when the lessee violates the conditions of the leasing agreement. However, the seizure of equipment is the most extreme measure to be taken by the lessor. This is confirmed by the results of the survey: if the lessee fails to make payments, the first step taken by leasing companies is negotiations and reviewing payment schedules. Less than 10% of respondents turn to the courts to force the return of the leased asset. Lessors have doubts about the ability of the courts to protect their property rights. Only when creditors, in particular
leasing companies, can be confident that their rights as owner-creditor will be defended, will leasing become more accessible.\textsuperscript{16}

Despite problems connected with the protection of property rights in the courts, lessors typically require less collateral than comparable bank loans, indicating that they believe owning the asset provides them with additional security. Complaints in this respect tend to focus on the amount of time required to repossess equipment through the courts.

The importance of this question should not be exaggerated, however. Leasing companies in all jurisdictions tend to believe that repossession is too difficult, not just in Russia. In practice, most companies try to structure their lease deals in such a way that the lessee has no interest in retaining the asset, so that the asset is returned on a non-contested basis. The best example of such is the practice with vehicle leasing: most leasing companies register the vehicle themselves, and in case of non-payment, it is (relatively) easy to revoke the vehicle registration. Since an unregistered vehicle is useless on public roads, the lessees often simply return the vehicle.

**Poor knowledge of leasing**

The leasing sector in Russia is still small, partly due to the fact that the mechanism and advantages of leasing are not clear to potential lessees, particularly in the regions. This low level of knowledge creates two problems: first, potential lessees do not make use of leasing when appropriate or attempt to use it when inappropriate), and second (as many leasing companies comment) concluding a lease agreement requires considerable additional educational work with clients, raising costs significantly.

For this reason, one of the main activities of the Leasing Development Group is education by means training programs throughout Russia and the group’s publications. A special seminar for lessees was organized and successfully held in 13 Russian cities in 2001 and the first half of 2002.

**Underdeveloped secondary equipment markets**

Since leasing companies (compared to other financial institutions) typically take more equipment risk, the existence of predictable prices for the equipment over the term of the lease agreement are important. Without predictable secondary markets, leasing is less advantageous and, at the margin, some leasing deals will not be concluded.

The secondary market for equipment in Russia is currently developed only for vehicles. This is one of the reasons why leasing companies frequently begin with vehicles and only expand once they have gained some experience in leasing and can better assess risks. Some suppliers have started to address this problem by providing Russian companies with buy-back guarantees, thereby taking on part of the risk themselves. Our survey shows that last year the number of deals involving suppliers’ guarantees increased 10%.

\textsuperscript{16} In our opinion, the problem of protecting the property rights of leasing companies was partly resolved in the amended Arbitration-Procedural Code, which involves the transfer of disputed equipment to the custody of the plaintiff or another entity as a means of securing the claims arising from a suit. A court does not have the right to refuse to secure a suit if the plaintiff provides counter security.
SHORT REVIEW OF THE CURRENT LEGISLATIVE BASE

Appendix “Russian leasing legislation” outlines the legal and regulatory framework for leasing in more detail.

The Russian civil code (article 665) defines leasing as follows.

*Under a financial rental agreement (leasing agreement) the lessor is obliged to acquire property indicated by the lessee from a seller stipulated by him and to supply this equipment to the lessee in return for payment for temporary possession and use for entrepreneurial purposes. The lessor in this case does not bear responsibility for the choice of the leased asset and the seller. A financial rental agreement may state that the choice of the seller and the equipment supplied is made by the lessor.*

On terminology, the Russian legal definition for leasing differs from that generally used internationally. There are two main differences:

1) Leasing refers only to financial leasing or capital leasing. Operational leasing is simply considered rental.17
2) Formal rules-based definition. The Russian Civil Code defines certain characteristics of a leasing deal. Lease agreements which do not meet these tests are not considered leases, although they may meet the test for rent agreements.18

There is no equivalent to the substance-based tests common in international accounting principles. As a result, some lease arrangements that may be classified as operational leasing in other countries may be considered (financial) leases in Russia, and rent agreements in Russia may be financial leases under standard international practice.

Throughout this text, we use the term leasing to mean financial rental (leasing) in the Russian sense unless otherwise specified.

The current legislative base for leasing in Russia is reasonably well developed. The most important legislative acts regulating leasing are the Civil Code, particularly chapter 34 which defines leasing, and also the Federal law “On Leasing,” which was passed in fall 1998. As Russia joined the UNIDROIT convention on international financial leasing in 1998, this document is also part of the legislative base on leasing in Russia.

17 In this sense, Russian is somewhat more logical than the English term, since in English, operational leasing simply refers to rental that is longer than one year. Although the term ‘operational leasing’ is sometimes heard in Russian, the term has simply been borrowed from English and has no legal meaning at present.
18 The best example is perhaps the requirement in Russia that equipment be used ‘for entrepreneurial purposes.’ While the application of this requirement is controversial, in practice it means that any lease agreement that does not meet this test would simply be considered a rental agreement.
The abovementioned documents establish:

- the basic conception and definition for leasing;
- significant freedom of contract (in accordance with the Civil Code);
- a favorable tax regime, largely due to the use of accelerated amortization for leased property, as well as the expensing of lease payments, hence reducing taxable profits.

Leasing deals are considered to be a type of rental contract, and as such, are defined by a number of characteristics:

- financial rental (leasing) involves three parties to a deal: the lessor, the lessee and the supplier of the equipment; (seller). As a rule, the supplier and the lessor do not have direct contractual relations, although with buy-back leasing the the lessee also acts as the supplier (note that buy-back leasing is not separately defined);¹⁹
- as part of a leasing deal two or more contracts are entered into, including a sale agreement and a lease agreement. Other agreements may also be entered into, such as an insurance agreement, a credit agreement, an agreement for technical servicing of the leased property, etc.
- the leased asset should be used for entrepreneurial purposes only;
- the property should be acquired specifically for leasing purposes.

Financial rental (leasing), as defined above, is subject to a favorable taxation regime described in other sections.

The requirement that leased assets be used for entrepreneurial (that is, commercial) purposes has two important implications. First, financial leasing does not apply to individuals for personal use (leasing may be used for unincorporated entrepreneurs²⁰). Second, it cannot be used directly to government agencies (although government-owned companies are not excluded). In both cases, the only important result is that any separate tax regime applied to leasing is not allowed in these two cases. In our view, this limitation is appropriate, since the tax advantages granted by the Russian government are intended to encourage private investment in productive assets. The tax benefits accorded are not intended to be used for personal consumption (by individuals) or by government directly (which would amount to government subsidizing itself, which it could do more efficiently otherwise).

The interpretation of ‘entrepreneurial use’ is, in practice, broad enough that virtually any legitimate company activity is valid, and we have seen few disputes on this point.

¹⁹ Note that the supplier and the lessor may not be the same party, as the acquisition of the equipment is an obligatory condition.
²⁰ Individual entrepreneurs use a separate legal unincorporated form, the “PBOYuL”, or “Entrepreneur without Status of a Legal Person” or legal entity. Leasing for such entrepreneurs is not a problem.

At the start of 2002 the Federal law from January 29, 2002 No. 10-FZ “On Amendments and Addenda to the Federal Law ‘On Leasing’” came into force. This law removed contradictions between the law “On Leasing” and other legislative acts, particularly the Civil Code and the Tax Code. Internal contradictions in the law itself were also removed.

This is perhaps the single most important change in the leasing market this year, since the legal and tax uncertainties created by these various contradictions raised risks considerably. Previously, leasing deals concluded in good faith based on a reading of any one of these legislative acts could subsequently discover that certain provisions were simply considered invalid. Or, even after doing considerable homework, they could also discover that tax authorities in a certain region had a different interpretation.

As a result of changes in the law on licensing, the licensing of leasing activity was abolished in late 2001. In our opinion this should have a positive effect on the development of the market for leasing, although some leasing companies were opposed to this change. Supporters of licensing argue that ‘unscrupulous operators’ could damage the development of leasing, or somehow tarnish the image of leasing. Others argue that without licensing, leasing will be used in illegal tax avoidance schemes (and again, leasing as a whole will suffer). Still others have argued that leasing companies with insufficient experience or professionalism will go bankrupt.

In our view, the licensing regime that existed before was a bureaucratic hindrance that served no public policy purpose. In practice, the licensing regime did not guard against unscrupulous or incompetent operators, nor did it limit the use of leasing for illegal tax avoidance schemes. From our discussions with numerous leasing companies and other financial institutions, it did serve to limit or delay entry by some very good companies with substantial resources, hence restricting growth of the market. In truth, the previous regime did not provide for any effective test of the quality or honesty of a leasing company.

As for illegal operations, there is an entirely separate body of Russian law that applies. Similarly, ‘unscrupulous operators’ are subject to all the provisions of the Civil Code and other regulatory acts. As for ‘incompetent’ leasing companies, they should go bankrupt: the funds they are (mis)using could surely be put to better use elsewhere. This is the point of financial intermediation, of which leasing is only one tool. Since leasing companies may not take public deposits (they are not banks), we see no compelling public policy interest arguing for licensing.

The general concern on licensing appears to be that leasing ‘as a whole’ will somehow be damaged. While this may be possible, the real question is whether the government, by means of the licensing regime, was either doing so or is the appropriate body to do so. Worse, in practice, the existing licensing regime served little purpose other than to limit competition. The argument about whether a ‘better’ licensing regime could be devised seems to us a theoretical discussion.
SURVEY RESULTS: LEASING INDUSTRY PRACTICE

Our description of the legal environment above is largely analytical. In practice, of course, there are a number of other important legal aspects that can best be understood by considering the experience of industry players. In a later section of this survey, we outline the results of a poll done amongst leasing companies, some of which we outline here to illustrate legal practice in the Russian leasing industry today.

Guarantees for leasing deals
It is still common practice for Russian leasing companies to require additional guarantees (in addition to the leased asset). This is a function of a number of different market issues, including the perceived riskiness of lending in Russia, the difficulty repossessing assets or seizing assets offered as security, the lack of secondary markets, and the lack of supply on credit markets (lenders ask more because they can). Although leasing is often perceived or marketed as ‘lending without collateral,’ this is frequently not the case.

Nonetheless, our survey results indicate that the number of companies requesting no additional collateral has grown, which may indicate improved economic or legal conditions.

As in previous years, the most popular means of ensuring enforcement of an agreement is to provide additional property as collateral. In 2002 this means of security was used by about 80% of leasing companies polled.

Meanwhile, the number of lessors requiring advance payment as security increased to 78% (an increase of 8% from 2001).

A significant number of deals continue to include insurance of the leased asset. The asset is insured by the lessor roughly as frequently as by the lessee. The number of deals using suppliers’ guarantees has increased 8%, a positive development in the industry.

A significant number of leasing agreements involve the provision of guarantees by a third party, usually a related corporate entity. At the same time, we should note that the number of deals entered into under guarantees from a corporate entity fell more than 7% over the past year.

Other means of securing agreements include: deposits (cash guarantees) (16%) and bank guarantees (35%).

Resolution of conflicts
An analysis of information on the non-fulfillment of obligations by the lessee and the actions of leasing companies in response allows us to make the following conclusions.

Leasing companies, as a rule, try to avoid the last resort of conflict resolution, the courts. The majority of conflicts are resolved by negotiations with the lessee, which usually end with a review of the payment schedule (53% of disputes) and/or by the provision of stag-
gered payments (41%). This, of course, does not relieve the lessee of his debt under the leasing agreement.

There has been a statistically insignificant increase in the number of deals dissolved by the lessor due to lack of payment (from 32% to 34%). At the same time, as lessors have started to use the undisputed withdrawal of funds (from the lessee’s bank account) more frequently, the number of these cases has increased from 30% to 37%. There have also not been any significant changes in accelerated payment – 8%-9% of those polled use this measure in the event of the lessee not meeting his obligations.

The number of cases where the leasing company seizes property without going through the courts has not changed, and does not exceed 5%.

If a leasing company decides to turn to the courts, the aim of the suit is not always to dissolve the agreement and/or to seize the property. About half of the suits are filed to recover overdue leasing payments rather than repossess the asset. Uncontested return of the leased asset is also relatively common.

**Legal problems**

As in previous years, the problems most frequently occurring are those involving tax regulation and accounting for leasing operations. Amendments to the Tax Code of the Russian Federation which came into force from January 1, 2002, should change this situation. Since our survey of leasing companies primarily concerned the 2001 calendar year (before the bulk of the changes went into effect), we did not expect to see any major change in the survey results. Our impression from discussions with leasing companies is that the situation has improved, but we will have to await next year’s survey to confirm this.

Leasing companies have some questions in the area of civil-legal regulation of leasing activity. We hope that as the amendments to the Law on Leasing have now taken effect, the number of these issues will be significantly reduced in future. In addition, in our opinion, recommendations published by the Supreme Arbitration Court of the Russian Federation should have a positive influence on the civil-legal regulation of leasing activity. This particularly applies to the early dissolution of leasing agreements.

As in the past, lessors encounter significant problems in repossessing assets. Unfortunately, a simple and effective mechanism for repossession is not likely to appear in the near future. Thus, detailed and clear provisions in the leasing agreement are especially important.
BRIEF DESCRIPTION OF TAXATION AND ACCOUNTING OF LEASING DEALS

TAXATION

In the recent past there have been significant changes in the area of taxation, many of which affect leasing. The main change was the passing of Chapter 25 of the Tax Code of the Russian Federation, regulating a mechanism for calculating and levying profit tax. In combination with the Law on Leasing, the contradictions between the various acts have been resolved, which also increases certainty for leasing market participants.

Adoption of the Tax Code

Chapter 25 of the Tax Code of the Russian Federation, which regulates profit tax, came into effect on January 1, 2002. In the initial versions of the draft law, leasing lost one of its main tax advantages, the possibility of applying accelerated depreciation. A number of draft laws restricted the choice of balance sheet for the leased asset. The situation was complicated by the fact that even after Chapter 25 was passed, the State Duma considered amendments to this chapter for a long time.

Main changes to profit tax

The revised version of Chapter 25 changed the principles for calculating profit tax. Here are the main changes:

- reduction of the profit tax rate to 24%;
- abolition of most tax breaks, including tax breaks capital investment;
- changes to the calculation of depreciation;
- a new system for deducting interest expense;
- restrictions on the use of the cash accounting method;
- the period for reporting losses was extended to 10 years following the tax period in which this loss was incurred;
- the majority of restrictions on deducting expenses were removed (previously, a large number of business expenses, such as advertising expenses, were not eligible expenses for the purpose of profits tax calculation).

These provisions are dealt with in more detail in Appendix “Taxation and Accounting of Leasing Deals.”

Retaining the basis for the tax treatment of leasing

As a result of repeated appeals by leasing companies to a working group set up in the State Duma (to develop the Tax Code), it was decided to retain and confirm the principles of the existing tax treatment for leasing. These are:

- the right to choose how to account for the leased asset (on the balance sheet of the lessor or the lessee);
• the lessee’s right to expense leasing payments in full;
• accelerated depreciation of up to three times for most types of equipment.

We should note that some changes in the tax system led to a slight reduction in the relative attractiveness of leasing as compared to regular borrowing. In particular, regardless of the reason for which the borrowed funds were received, interest expenses are now deductible.\textsuperscript{21} This brings the tax system in Russia into line with the majority of other countries, and it is expected that this will help develop the financial markets. The change in the profit tax rate from 35\% to 24\% also helped reduce the relative attractiveness of leasing.

In our opinion these are unambiguously positive changes, and should not lead to a reduction in the market for leasing. The reduction in the profit tax rate should stimulate business and, as a result, companies will move to acquire fixed assets and receive financing. These changes, broadly speaking, establish a more coherent and logical form of incentives for private companies to invest.

\textbf{Upcoming changes}

The reform of the tax system in Russia is continuing and changes are expected both in the system for calculating and paying taxes, and also in the number of taxes. From the beginning of 2003, the ‘road tax’ – a turnover tax of 1\% on revenue – will be abolished. This tax (and the tax on transport vehicles) is expected to be replaced by a general transport tax. The transport tax rate will depend on the engine capacity of the vehicle. Since turnover taxes are particularly burdensome for financial institutions (which have high revenue on relatively small margins), this change should benefit leasing companies, banks, and their customers (who will benefit from reduced margins).

At present, amendments are being considered to the second part of the Tax Code, which will introduce a simplified taxation system for small businesses (for more detail see appendix “Taxation and Accounting of Leasing Deals”).

Despite the many positive taxation changes that have taken place in the recent past, some difficulties remain. Occasionally, the provisions of regulatory acts (or explanatory documents such as instructions from the relevant government agencies) are drawn in a contradictory fashion or are unclear, leaving the parties in a leasing deal with ambiguous interpretations of taxation legislation. Enforcement or interpretation in the regions can also be uneven, particularly where leasing is less common.

\textbf{Survey statistics}

Again, we provide here some results of our poll of leasing companies to indicate the current practice in the leasing industry and the problems encountered by market participants. Since these responses concern 2001, before the majority of changes to the Tax Code and

\textsuperscript{21} Remember that in accordance with the law “On Profit Tax for Companies and Organizations,” in effect until January 1, 2002, interest on credits received to acquire fixed assets could be accounted for as costs by the leasing company only. Companies involved in other types of activity, after the installation of the equipment paid interest from net profit.
the Law on Leasing took effect, these may not represent current practice or experience as well as in previous years.

Problems in the areas of accounting and taxation were encountered by 55% and 77% respectively of those companies that participated in the survey. However, the percentage of companies that had conflicts with the tax authorities has fallen from 25% in the last survey to 20% this year. As in previous surveys, Value Added Tax (VAT) was the leading area of conflict. The second most problematic area is accounting for expenditures (ex-pensing payments).

Diagram 5: Typical problems with the tax service

Source: IFC Leasing Development Group
ACCOUNTING

Accounting, like the tax system, is currently undergoing reform and experiencing constant change, which undoubtedly causes additional difficulties for both lessor and lessee.

The Russian accounting system, inherited from the socialist period, did not provide a clear picture of the financial condition of a company. This created significant difficulties for potential investors and creditors, who demanded reports prepared in accordance with GAAP or IAP. In particular, there has traditionally been no split between accounting and reporting for shareholders and accounting for tax purposes. Since the mid 1990s there has been talk of switching to international accounting standards or at least some system in better compliance with the main principles. In 1998, the Russian government confirmed a program for reforming the accounting system, which the Russian Finance Ministry and other departments started to implement.

One option was to simply translate international accounting standards into Russian and apply them. However, according to Finance Ministry officials, the adaptation of international standards “taking national peculiarities into consideration” is a more promising option, despite the fact that this will take much more time. Over the past few years (beginning in about 1998), companies have already been introducing new accounting standards. In the long-term, reform should ensure the creation of an accounting system that would reflect the peculiarities of corporate taxation and provide information needed by company founders and managers.

With the adoption of Chapter 25 of the Tax Code, accounting differs substantially from tax reporting. Organizations now need to implement two accounting policies: one policy for the purposes of management and shareholders in accordance with Accounting Regulation 1/98 “Corporate Accounting Policy,” and one for tax purposes. Additional difficulty is caused by the fact that the initial documents for both the systems are different, as the definition of taxable items and revenue and expenditure declared for taxation largely differ from the definition (categories) for reporting purposes.

The main differences in accounting and tax accounting arise when establishing:

- the initial cost of a leased asset;
- amortization policy;
- the lessee’s expenditure;
- the amount of interest on credits that may be applied to expenditure.

The main document regulating accounting for leasing operations is Finance Ministry Decree No. 15 “On Reflecting Operations under Leasing Agreements in Accounts” from February 17, 1997, though in practice, the parties must comply with various other regulatory documents, such as the Statute on the accounting of revenue, expenditure and fixed assets.
Accounting for leasing deals differs based on whose balance sheet the asset is carried on. We should note that accounting on the balance sheet of the lessor is more clearly dealt with in regulatory acts and is therefore preferred: according to our survey 59% of leasing companies prefer to include the property on their own balance sheets, 34% include the property both on the balance sheet of the lessor and of the lessee (depending on the specific circumstances) and only 7% record the asset exclusively on the balance sheet of the lessee.22

For more detail see Appendix “Taxation and Accounting of Leasing Deals.”

22 Aside from the more clear regulations, some leasing companies have felt that carrying the asset on their balance sheet helps reinforce their ownership of the underlying asset. While this is not the case under the Civil Code, the belief has been that courts, relatively unfamiliar with leasing and the separation of ownership and usage rights, may give some weight to who ‘owns’ the asset in accounting terms.
LEASING MARKET IN 2001

SIZE OF THE RUSSIAN LEASING MARKET

The State Statistics Committee (hereafter Goskomstat) is the official source of statistics on leasing operations. According to Goskomstat, equipment was acquired for subsequent leasing in the amount of 7.8 billion rubles in 2001, i.e. about $267 million (in 2000 – 5.8 billion rubles or $200 million).23

As in previous years, we believe the Goskomstat figures are extremely low. For example, the voluntary participants in our poll (which represents only a fraction of the industry) reported roughly $100 million more to us, indicating that Goskomstat’s data are suspect.

According to the our own estimates, the volume of the Russian leasing market was significantly higher in 2001 and reached $1.7 billion. In 2002, we forecast the market will reach $2.3 billion.24

In 1998-2000, growth in the leasing market was primarily a result of the fast growth of the Russian economy. From mid 2001 to the present, this growth has been due to increased domestic demand for leasing. In our opinion, the market for leasing will continue to grow for the following reasons.

Legislative changes in 2001 significantly reduced the risks for participants in leasing deals. The passing of the chapter “On Profit Tax” in the Tax Code of the Russian Federation reduced uncertainties in taxation and the adoption of amendments to the law “On Leasing” removed contradictions in the civil-legal sphere. We have seen continued growth in the number of leasing companies and the size of existing leasing companies, and the removal of licensing has spurred even more market entry. In addition, increased access to foreign capital will undoubtedly have a positive influence on this market segment.

However, the main growth engine in the leasing market is domestic demand for long-term financing (in addition to short-term financing, which still dominates on the Russian credit market) as well as increased financial intermediation. The increased tenor of available ruble financing (as well as currency financing available onshore) will also play a role, as leasing is by definition a longer-term form of finance.25 Finally, while the market is still underdeveloped, leasing is no longer as ‘exotic’ as it was in previous years.

23 To translate statistical information into dollars we have used the average exchange rate for 2001, which amounted to about 29.22 rubles.
24 Other independent estimates are closer to our own estimates, and few believe the Goskomstat figures to be accurate. Indeed, some Russian government departments, including the Ministry of the Economy, have started using our estimates. Better data from Goskomstat would be of significant interest to market participants.
25 Note, for example, that domestic ruble bonds have been slowly increasing their tenor, although available debt financing remains primarily short-term.
Leasing market: forecasts for 2002-2003

We expect that the volume of leasing operations in Russia will grow, despite factors inhibiting the development of leasing. The primary driver of additional growth in 2002-2003 is the changes to the legislative and regulatory environment, which have both reduced risks and barriers to entry such as licensing. Demand for leasing as an alternative means of financing the acquisition of fixed assets is constantly growing. Leasing is an effective method for small companies in particular to acquire fixed assets which, in the end, can significantly contribute to economic growth. In addition, this is an effective investment mechanism that may play an important role in the process of renewing production assets at Russian companies.

Our research indicates that, the Russian market for leasing will amount to $2.3 billion in 2002 and $2.8 billion in 2003. This evaluation forecasts increased growth in the Russian leasing market, partly due to the removal of contradictions in tax and civil legislation. Our research demonstrates growth both in the number of companies, and in the number of deals carried out by existing companies in 2001. This trend was visible in the first half of 2002. The leasing market is likely to expand further in the future, as many market niches have not been tapped and in many regions of the country leasing is not sufficiently used. In some regions, the leasing market remains essentially wide open.

Nevertheless, participants in the leasing market continue to encounter a number of problems. The Russian leasing sector still lags behind other countries and is not in a position to fully meet demand. The main difficulties facing Russian leasing companies are internal (for example, insufficient access to finance, insufficient equity and a lack of experienced personnel) rather than external, as was the case previously (contradictions in the legislative and regulatory sphere). Consequently, we believe our forecast of the increased growth rate of the Russian leasing market over the next two years is somewhat conservative and more than likely underestimates rather than overestimates its actual size.

Table 3: Volume of Russian market for leasing

<table>
<thead>
<tr>
<th>Years</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002 (forecast)</th>
<th>2003 (forecast)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ Billion</td>
<td>1.4</td>
<td>0.4</td>
<td>1.2</td>
<td>1.7</td>
<td>2.3</td>
<td>2.8</td>
</tr>
<tr>
<td>Billion rubles</td>
<td>14.4</td>
<td>10.6</td>
<td>35.2</td>
<td>49.7</td>
<td>72.45*</td>
<td>95.2*</td>
</tr>
</tbody>
</table>

Source: IFC Leasing Development Group

* Based on exchange rates forecast by the Economist of 2002 – 31.5 rubles to the dollar, for 2003 – 34 rubles.

Methodology

We define the volume of the leasing market as the cost of the equipment leased out in a year.

The volume of the country’s leasing market may be estimated as a function of several macroeconomic indicators, in particular as a share of the volume of investment in fixed assets, the volume of equipment imports or as a share of GDP. Naturally, in countries with developed leasing markets these shares are higher. In selecting a ratio for estimating the Russian leasing market, we decided to adopt a conservative approach and take the
bottom level of the ratio for less-developed countries. Consequently, we believe these estimates to be conservative.

We also compared these estimates with the information provided by the approximately one hundred companies that provided us with sufficiently detailed information on the size of their operations for 2000 and 2001. While the figures are not directly comparable, they do provide an indication of the trends and a back-check to ensure our estimates are reasonable. The main deficiency of our survey results is that they do not capture the entire market (provision of information is voluntary), and some particularly large players have not provided us with information.26

When forecasting, we did not take into consideration the possibility of any major economic upheaval similar to the crisis in 1998. In evaluating these risks, we relied on information from the Economist Intelligence Unit.

**Share of leasing in investment in fixed assets**

According to statistics, in OECD27 countries, leasing comprises 15-30% of the total volume of investment in fixed assets. In developing countries with less developed leasing markets, from 3% to 15% of investment is carried out through leasing.

In 1999 we calculated that leasing in Russia amounted to only 1.5% of total investment, which reflected the post-crisis lack of credit resources, particularly longer-term funds. However, as already noted, in 2000 the sector experienced growth and this indicator returned to its pre-crisis level of 3%.

In evaluating macroeconomic parameters that have conflicting influences on the leasing market, we prefer to stick to a conservative estimate that in 2001, the share of leasing in total investment remained at 3%. However, in arriving at forecasts for 2002 and 2003 we believe that as a result of positive changes in the legislative and tax base, as well as increased domestic demand, can the share of leasing in fixed investment will grow to 4%.

**Table 4: Size of leasing market as a share of investment in fixed assets**

<table>
<thead>
<tr>
<th>Share of leasing</th>
<th>2000</th>
<th>2001</th>
<th>2002 (forecast)</th>
<th>2003 (forecast)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in tangible assets ($ billion)</td>
<td>$40.75</td>
<td>$55.18</td>
<td>$60.84</td>
<td>$68.90</td>
</tr>
<tr>
<td>1.5%</td>
<td>0.61</td>
<td>0.83</td>
<td>0.91</td>
<td>1.03</td>
</tr>
<tr>
<td>3.0%</td>
<td>1.22</td>
<td>1.66</td>
<td>1.83</td>
<td>2.07</td>
</tr>
<tr>
<td>4.0%</td>
<td>1.63</td>
<td>2.21</td>
<td>2.43</td>
<td>2.76</td>
</tr>
</tbody>
</table>

Source: Information from the research department at The Economist magazine; IFC Leasing Development Group.

26 In particular, we have not been able to get information from the government-funded agricultural leasing companies nor aircraft leasing companies. Our respondents also include only leasing companies operating domestically, and hence leave out any cross-border leasing.

27 Organization for Economic Cooperation and Development, which unites 29 countries.
At a 3% share of total investment in fixed assets the volume of the Russian leasing market in 2001 would be $1.66 billion.

**Volume of leasing market as a share of imports of fixed assets**

In countries with developed markets, leasing accounts for 20%-30% of imports of fixed assets. In 1999, according to our estimates, in Russia this share amounted to not more than 7.5% due to the lack of hard currency to finance leasing deals. At the moment, we estimate the level to be about 10%.

**Table 5: Size of leasing market as a share of equipment imports**

<table>
<thead>
<tr>
<th>Year</th>
<th>Import of equipment (billion USD)</th>
<th>Share of leasing</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>14.1</td>
<td>10.0%</td>
</tr>
<tr>
<td>2001</td>
<td>17.22</td>
<td>12.5%</td>
</tr>
<tr>
<td>2002 (forecast)</td>
<td>18.5</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

*Source: Information from the State Statistics Committee for 2001, and from the research department at The Economist magazine for 2000 and 2002; IFC Leasing Development Group.*

At a 10% share of equipment imports, the size of the Russian market for leasing in 2001 totals $1.72 billion U.S. dollars.

**Share of leasing in GDP**

Our evaluation of the volume of the leasing market assumes that the share of leasing in GDP amounts to about 0.5%-1% (in developed countries this indicator is approximately 2% to 5%).

**Table 6: Size of leasing market as a percentage of GDP**

<table>
<thead>
<tr>
<th>Years</th>
<th>GDP (billion US$)</th>
<th>Share of leasing</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>259.60</td>
<td>0.50%</td>
</tr>
<tr>
<td>2001</td>
<td>310.00</td>
<td>0.65%</td>
</tr>
<tr>
<td>2002</td>
<td>338.90</td>
<td>0.75%</td>
</tr>
<tr>
<td>2003 (forecast)</td>
<td>376.60</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

*Source: Information from the research department at The Economist magazine; IFC Leasing Development Group.*

At 0.5% of GDP the volume of the Russian leasing market in 2001 amounted to $1.55 billion.

Based on the above calculations, we estimate that in 2001 the size of the Russian leasing market was $1.7 billion U.S. dollars.
This market evaluation is conservative, as we chose the lower range of the possible share of leasing in the various indicators. We consider that this market volume is realistic, and is supported by the results of the survey carried out by the IFC Leasing Development Group when preparing this report.

Poll of Russian leasing companies
From April to May 2002, the Leasing Development Group carried out a survey among Russian leasing companies. We received a response from 114 leasing companies, or 23% of the approximately 500 resident leasing companies actually operating in 2001. About 100 of these provided detailed information on the value of their leasing portfolio, the number of deals and the minimum and maximum size of the deals. During the survey and in interviews with leasing companies we received further information on their leasing portfolios and the companies’ policies and regulations.

When analyzing the information we calculated the average, median, minimum and maximum indicators. Due to the fact that the average value is distorted by the presence among the respondents of several large leasing companies, the median value is often more indicative of the state of the market.

The survey results confirm that the true size of the leasing market in Russia is significantly higher than the Goskomstat data. Information is provided exclusively on a voluntary basis, and hence is not complete. Despite these deficiencies, respondents reported that they entered into $362 million worth of leasing deals in 2001, or almost $100 million more than the State Statistics Committee’s estimate.

The survey broadly confirms our estimate both of the size of the market and market trends. Given that our survey has a varied selection, covering all categories of leasing companies, and the volume of deals entered into by 23% of active leasing companies (excluding some large players) amounted to $362 million, we can conclude that the size of the Russian leasing market was $1.7 billion in 2001. Various other information collected also confirms our forecast of rapid growth in the leasing market in 2002. Again, we believe these estimates to be conservative.

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28 See the section “Number of Leasing companies” for a detailed account of the number of leasing companies actually operating in Russia. This number is an estimate, and does not account for one-off deals or non-leasing companies carrying out leasing, upon which there are currently no restrictions.

29 The median is the mid-point in the range of values, rather than the arithmetic mean. It is often more indicative when the distribution of values is such that particularly large or small values skew the average (arithmetic mean).
NUMBER OF LEASING COMPANIES

An important indicator of growth in the sector is the number of leasing companies submitting applications for leasing licenses. The dynamic of the number of registered leasing companies is as follows.

Diagram 6: Number of licensed leasing companies

<table>
<thead>
<tr>
<th>Year</th>
<th>Leasing Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>End of 1996</td>
<td>240</td>
</tr>
<tr>
<td>End of 1997</td>
<td>550</td>
</tr>
<tr>
<td>End of 1998</td>
<td>620</td>
</tr>
<tr>
<td>End of 1999</td>
<td>937</td>
</tr>
<tr>
<td>End of 2001</td>
<td>1,825*</td>
</tr>
</tbody>
</table>

* - In 2001, licenses were granted only from April through the end of the year, and since then is no longer subject to licensing.

Source: Economic Development and Trade Ministry

In 2000-2002 a total of 888 leasing licenses were granted to residents of the Russian Federation and 27 to non-resident companies. For 2002 on, licensing is no longer required, and hence market entry should be more rapid.

We need to take into consideration that these indicators may include a significant number of companies that received a license to carry out one leasing deal but do not plan to be exclusively involved in leasing activity. The percentage of companies that are actually involved in leasing activity cannot be established with certainty, as after the receipt of a license, companies were not obliged to provide the licensing authority with any report on its activities. According to our estimates, and according to other analysts of the leasing

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30 Information from January 2000. This is unofficial information as in September 1999 the Russian Economics Ministry halted granting licenses and restarted only in April 2001. By that time 1,416 residents and 116 non-residents had been included in the Composite State Register of Licenses.
market, the percentage of actually operating leasing companies in was from 25% to 30% of the number of licensed companies. We expect that this trend continued in 2001. Consequently, as of mid-2002, we believe about 550 leasing companies were actually operating in the Russian Federation (in 2001 – about 500, in 2000 – 350). The large number of licenses received indicates that companies intend to use leasing in the future.

Since the removal of licensing, companies that do not have leasing as a core activity can also provide lease financing, which means that the market could be much larger than reported by leasing companies in future. We do not expect this to be a major factor in the development of the leasing market, as companies that provide leasing and related services tend to specialize. It will deepen and broaden, however, the provision of lease financing.

GEOGRAPHICAL LOCATION OF LEASING COMPANIES

The structure of the geographical location of leasing companies in the territory of the Russian Federation has not changed significantly in recent years.

Diagram 7: Geographical location of Russian leasing companies

As previously, most leasing companies are concentrated in the European part of Russia and in Moscow (79.7% of the total number of companies). The number of leasing companies registered in the Ural region and in Western Siberia has increased, but the share of these companies in the total number of licensed leasing companies has not significantly changed since 1999 (15.7% in 1999, 14.9% at the start of 2002). The share of companies registered on the territory of Eastern Siberia and the Far East has fallen by 3% - from 8.5% in 1999 to 5.4% at the start of 2002.

This may not fairly represent the extent of leasing services in the Urals, Siberia and the Far East (many financial companies are formally domiciled in Moscow but active in other areas). Our research and study of the leasing market nationwide so support, however, the conclusion that Eastern Russia (from the Urals to the Pacific) are relatively underserved by virtually any measure.

**Diagram 8: Geographical location of Russian leasing companies, 2002 vs. 1999**

![Diagram showing geographical location of Russian leasing companies, 2002 vs. 1999](image)

*Source: IFC Leasing Development Group, Russian Economic Development and Trade Ministry*

**STRUCTURE OF LEASING COMPANY OWNERS/FOUNDERS**

Based on the responses of participants in the survey, we derive the following picture of leasing companies’ owners and founders.
Diagram 9: Leasing company founders

Source: IFC Leasing Development Group.

The left column in Diagram 9 is the percentage of leasing companies in which the founder owns more than 50% of equity. The right column is the percentage of leasing companies that have this type of founder, regardless of the share owned.\(^3\)

Leasing companies are often founded by corporate entities, followed by private individuals and finally banks and financial organizations. We believe the proportion of banks that effectively control a related leasing company is underestimated by this information, as it is likely that bank shareholders or owners represent some of those reporting ‘corporate entities’ or private individuals as founders/shareholders.

**NUMBER OF EMPLOYEES AT LEASING COMPANIES**

The leasing companies surveyed (114) employ a total of 1,435 people. The average leasing company has eight employees, including two in management, two specialists in the accounting department and one each in the financial and marketing departments. Of course, for each concrete company these indicators vary significantly. For example, the average size of leasing companies surveyed amounts to 22 people and the largest number of employees reported was 80.

\(^3\) In total the indicator exceeds 100%, as in the majority of cases companies named more than one founder, stating, moreover, concrete share participation.
AVERAGE NUMBER OF DEALS

Deals entered into in 2001
On average, each leasing company entered into 44 leasing deals in 2001 (35 deals in 2000). The average volume of deals per company (in terms of the cost of the equipment) amounted to $4 million ($3.7 million in 2000). A 30% increase in the number of deals, with an insignificant increase in their total size per company, indicates that the average size of a leasing deal has fallen. Indirectly, this confirms that leasing companies are moving to higher-volume, lower-value per deal business models, which can only benefit small and medium-sized enterprises.

Portfolio of leasing deals
We define a leasing deal portfolio as the sum total of deals remaining on the leasing company’s books, and for which they are still receiving payments.

On average in 2001 the number of deals in the portfolio of Russian leasing companies increased by 30% (from 60% in 2000 to 79% in 2001). The median volume however indicates a smaller number: 20% in 2000 and 30% in 2001, though in this case growth in the median leasing portfolio amounted to 50%. Of course we have to take into consideration that some leasing companies entered into less than 10 leasing deals. The leader in terms of the number of deals entered into is a leasing company specializing in vehicle leasing. This company’s portfolio amounted to 1,000 leasing deals, of which 450 were signed in 2001.

The average volume of a company’s leasing portfolio, i.e. the total payments to be received on uncompleted deals, amounts to $16.4 million ($19.6 million in 2000). The size of this indicator was influenced by several companies with a very large number of deals, and the fall in the average value is caused by the increased number of companies reporting. The portfolio of the median leasing company was significantly less, and in 2001 amounted to $987,000 ($644,000 in 2000). The total portfolio of leasing companies surveyed increased 20% in 2001 to amount to $1.2 billion ($1 billion in 2000).

All indicators characterizing the condition of leasing company portfolios indicate growth, both for individual companies and in the sector as a whole.

Size of average leasing deal
We asked leasing companies to indicate the size of the minimum, maximum and average leasing deal entered into by the company. Analysis of this indicator provides yet another confirmation that the leasing companies surveyed are increasingly servicing small and medium-sized businesses. In 2001 the average size of a leasing deal at a median leasing company amounted to $58,000.

Table 7: Size of average leasing deals (Thousand US$)

<table>
<thead>
<tr>
<th>Year</th>
<th>Average</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>238</td>
<td>53</td>
</tr>
<tr>
<td>2001</td>
<td>169</td>
<td>58</td>
</tr>
</tbody>
</table>

Source: IFC Leasing Development Group
The size of maximum leasing deals varies from an average of $1.3 million to a median of $308,000. The significant range between these two indicators is due to companies working with very large deals. Even so, the data indicates that leasing is filling a niche of relatively lower-value deals than the banking sector.

**Table 8: Upper limit for leasing deal size (Thousand US$)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Average</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1,209</td>
<td>249</td>
</tr>
<tr>
<td>2001</td>
<td>1,338</td>
<td>308</td>
</tr>
</tbody>
</table>

*Source: IFC Leasing Development Group*

The same range, for the same reasons, is observed when analyzing the volume of the average minimum leasing deal. The average size in 2001 amounted to $210,000, while the median volume of the minimum leasing deal level amounted to only $7,000. Although the median volume increased slightly from 2000, these volumes indicate that some leasing companies are involved in small ticket or even “micro” leasing. Since the number of companies responding and the number of companies operating are also considerably higher, the increased size of the median minimum leasing deal does not really indicate that the lower end of the market has been ignored.

**Table 9: Minimum leasing deal size (Thousand US$)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Average</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>426</td>
<td>5</td>
</tr>
<tr>
<td>2001</td>
<td>210</td>
<td>7</td>
</tr>
</tbody>
</table>

*Source: IFC Leasing Development Group*
LEASING COMPANY CLIENTS

Search for clients
Russian leasing companies mainly search for clients using the contacts of their founders (79%), or contacts of suppliers (69%).\(^{33}\) Contacts of creditors and advertising are used by 54% and 53% of companies respectively. The role of the Internet in the search for clients is increasing from year to year and 34% of companies report using the internet for marketing.

Size of client companies
Leasing companies that participated in the survey mainly work with small and medium-sized businesses. Only 7% of the companies surveyed work exclusively with large companies. Clients of 38% of companies are small and medium-sized businesses and 40% work with all sizes of companies.

Diagram 10: Leasing companies by client size

\(^{33}\) Companies could note more than one point, therefore the total exceeds 100%.
TYPES OF EQUIPMENT

The range of equipment acquired by leasing is quite wide. There has been little change in the types of equipment leased since last year. The leader continues to be the leasing of transport vehicles: 64% of companies surveyed are involved in truck leasing and 56% in the leasing of passenger vehicles, followed by production equipment (44% of companies), telecommunications equipment (40%), food processing equipment (37%), trading equipment (35%) and printing equipment (30%). Leasing companies are also working with timber processing equipment, medical equipment, construction technology and aviation technology.

Diagram 11: Types of equipment leased

Source: IFC Leasing Development Group
It is not surprising that leasing companies prefer to lease transport vehicles. The reasons for this are as follows: transport vehicles are easy to reclaim, compulsory registration with the State Automobile Inspectorate simplifies the process of monitoring, and moreover, sales on the secondary market are not difficult.

Production equipment follows transport vehicles in popularity. This confirms the fact that leasing is fulfilling its function as a mechanism of alternative financing for production companies. Given that other types of equipment also may be considered as production equipment (for example, food processing equipment, timber equipment), the share of production equipment may be considered to be close to 50% of equipment leased.

“While a year ago clients mainly acquired transport vehicles and road construction equipment, now production equipment is moving into first place.”
Interleasing General Director K. Tsaryev in an interview with the newspaper Business Petersburg, June 2002.
SOURCES OF FINANCING

Leasing companies that participated in the survey received a significant amount of financing from Russian banks, both founder banks (29%), and third-party banks (71%). The amount of financing by outside banks has increased by 10% since the last survey, which corresponds with the latest trends in the development of the banking sector, particularly the increase in the volume of banks crediting. This is particularly encouraging for the longer-term development of the leasing sector, and also indicates increased lending on the part of banks.

Diagram 12: Sources of financing for leasing companies

Difficulties with bank lending arise largely with the length of available financing, as banks are much more interested in short-term crediting.

Interest rates
In 2001 the average interest rate in Russian rubles fell slightly to approximately 25% (in 2000 leasing companies financed clients at 26%-28% in rubles). The maximum interest rate reported was 42%. The interest rate on leases in hard currency has also fallen slightly to 14%-15% per annum (from 15%-16% in 2000). The maximum interest rate for currency financing was 22% per annum, and the minimum reported was 4% (clearly a concessional rate). The variance reported in ruble leases was considerably higher.
CHARACTERISTICS OF LEASING DEALS

Disposal of leased asset upon completion of leasing deal

In the overwhelming majority of deals (97%), the leasing agreement provides for the purchase of the property by the lessee. If the leased asset returns to the lessor (which happens with only 3% of deals), then the lessor either rents it out or sells it on the secondary market. This relative lack of flexibility is typical of emerging lease markets, and we expect this figure to fall slowly as lessees perceive the advantages of either acquiring only the use of the asset for a fixed period or of having only a purchase option. Lessors should also prove increasingly more willing to provide this option as secondary markets develop.

The survey shows that the purchase of equipment in 44% of cases is drawn up in a sale agreement and in 56% of cases is a separate item included in the leasing agreement.34

Term (length) of agreement

In the majority of cases (82.5%) the period of the leasing agreement corresponds with or is slightly (less than 20%) shorter than the period of amortization of the leased asset.

Currency

A total of 58% of leasing companies sign leasing deals in rubles, without establishing a hard currency equivalent or linking payments to another currency. 24% of companies usually establish a hard currency equivalent and 19% use one or the other depending on circumstances.

The currency used in a leasing deal is set out in the agreement itself. Leasing companies normally prefer not to take on currency risks and transfer this risk to the lessee. The large percentage of deals carried out without being tied to a hard currency equivalent indicates that the share of ruble financing for leasing companies is relatively high, and this is an encouraging development.

CONCLUSIONS

Information received during the survey indicates that leasing is currently one of the few means of long-term and medium-term financing accessible to Russian companies. The average leasing deal is signed for three years, corresponding to the depreciation periods of most assets after accelerated depreciation.

The wide range of equipment handled by leasing companies, 50% of which is production equipment, indicates that leasing companies are financing the real sector of the economy.

Leasing continues to be an alternative mechanism for financing small and medium-sized businesses, which is indicated by an analysis of the portfolio of leasing company deals.

The majority of leasing deals are entered into in rubles, without setting a hard currency equivalent; consequently lessees do not carry the risk of changes in the exchange rate.

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34 This distinction is currently not very important, although in previous years the inclusion in the leasing agreement was an issue due to Civil Code and leasing law restrictions.
TYPES OF LEASING COMPANIES

Leasing companies working in the Russian market may be classified by several characteristics:

- type of founder;
- size of client companies;
- geographical area of activity;
- sector.

CLASSIFICATION BY FOUNDER
Leasing company founders include:

- Russian banks;
- foreign banks or financing companies;
- financial-industrial groups;
- equipment producers;
- government entities;
- private individuals.

Bank-owned leasing companies

Leasing companies owned by Russian banks
In 1997, when the Leasing Development Group was launched, this category of leasing companies was the most common. Banks set up leasing companies for various reasons. Some banks use “their” leasing companies to equip their own offices, both main and regional, thereby “lightening” their balance sheets (on an unconsolidated basis, and few banks report on a consolidated basis). The majority of banks, however, considered leasing as an additional lending instrument. If a client applied to them for a loan to acquire an asset, then bank employees informed him of the possibility of receiving the same equipment under leasing, and sent him to the leasing company (which was often not physically separate).

Some leasing companies founded by banks have gradually expanded their client base and sources of financing, and have become more independent from their founders and gradually turned into independent leasing companies. In general, this process is common, as bank-owned leasing companies also discover that the sources of funding, means of operation, risks and client bases all differ from those of the banks. For example, leasing companies often establish more complex relations with suppliers.

A clear example of this is the company Baltic Leasing. Established in 1990 by Promstroibank (St. Petersburg), at first it mainly serviced bank clients using funds from the parent bank. Our market review for 1998 contained the following information: in 1997 almost 90% of Baltic Leasing deals were with clients of Promstroibank, using the bank’s financing. Over the past four years the situation has completely changed. First of all, Bal-
tic Leasing’s client base has expanded significantly with companies that are not clients of Promstroibank, and also from other regions (Baltic Leasing clients are not only in the northwest region, but also in southern Russia and in the Urals region). Along with credit lines from Promstroibank, Baltic Leasing also uses funds from outside banks and suppliers’ credits.35 Baltic Leasing is a clear example of how a leasing company established by a bank tested out leasing deals with the bank’s client base and its credits, and then successfully expanded its client and credit base and acquired relative independence from the founder bank.

This is not the trend for all companies, of course. The company Leasingbusiness – also one of the first leasing companies in Russia – was established by Mosbusinessbank in 1992. According to information published in our 1998 report, 90% of Leasingbusiness clients were clients of Mosbusinessbank, and the bank was the primary source of funds. Over the past four years, the Bank of Moscow Bank acquired Mosbusinessbank and Leasingbusiness now works mainly with the Bank of Moscow’s clients. As before, a significant share of deals (over 90%) are signed either with the bank’s clients or with the bank itself. Many leasing companies set up by banks operate under the same scheme.

Naturally, this specialization has some positive aspects, but it also includes a lot of dangers. If something happens with the parent-bank, then the leasing company finds itself in a pretty shaky situation – it is not able to sign new leasing deals due to the absence of finance and, consequently, may cease to exist.

The biggest single problem with this business model is that Russian banking regulations currently cap the total amount of lending to any one company or group of companies (including a wholly-owned or controlled subsidiary) at 25% of capital. Hence, the upper limit of financing for all bank-owned leasing companies that source funds only from the parent is clearly established. Given the small capital base of most Russian banks, this is a significant restriction.36 Outside lenders will rarely lend to a leasing company with no equity, and many bank-owned leasing companies were founded with the minimum level of capital required to register a company, currently 10,000 rubles.

Based on our observations, many leasing companies established by banks are now exhausting their growth potential as the bank reaches its lending limits. At this point, the options available boil down to capping the size of the leasing company and signing little or no new business, or capitalizing the leasing company and finding outside sources of finance.

In our opinion, leasing companies that were set up by banks have considerable potential to become independent leasing companies. Such companies have an excellent opportunity to gain leasing experience on the established client base, lending technologies and

35 Baltic Leasing has also borrowed funds from the International Finance Corporation, the IFC’s first investment in a wholly-owned Russian leasing company.

36 In previous years, we had informally heard that the solution was to found a second leasing company, also wholly-owned. Anecdotal information suggests that the Central Bank is enforcing this restriction more carefully, and this dodge no longer works.
infrastructure of the bank while at the same time establishing its own credit history. To develop successfully, the company needs to find new creditors and expand its client base, as well as take advantage of the different risk and funding characteristics of leasing to be as competitive as possible.

**Leasing companies founded by foreign banks**

This group of leasing companies is small. The undoubted advantage of these leasing companies is their access to long-term financing at low interest rates. Does this represent a danger for Russian leasing companies? On one hand, yes, as potential lessees will prefer cheaper leasing contracts. However, not every lessee will suit a leasing company with a foreign founder, although a Russian leasing company may be willing to take the client risk. To date, foreign banks have preferred to work with the most credit-worthy borrowers, and have tended to concentrate on the high end of the market. In the end, no foreign bank will take an unlimited amount of Russian risk, and the only solution will ultimately be to raise funds locally – at which point they will cease to be fundamentally ‘foreign’ in any meaningful economic sense. In the final analysis, foreign banks will play a role in the market, but are unlikely to dominate.

Speaking of leasing companies established or controlled by foreign banks or financial institutions, it is worth mentioning two of these companies – Delta Leasing, founded by the U.S.-Russia Investment Fund (TUSRIF) and KMB Leasing, founded up by KMB Bank (KMB in Russian stands for ‘crediting of small business). However, as these companies were set up especially to work with small and medium-sized businesses, we classify these companies according to their clients and describe their activity in more detail in the section “Companies Working with Small and Medium-sized Businesses.” In both cases, these companies may be primarily sourcing their funds abroad, but their long-term plans involve sourcing significant financing domestically.

**Leasing companies founded by financial-industrial-groups (“Reverse Captives”)**

Leasing companies founded by financial-industrial groups are created with one aim in mind, to supply equipment to companies in the group. Examples of these groups of companies include LK Leasing (Lukoil), RTK Leasing (Rostelecom), and Yukosleasing (Yukos). Banks that are also part of the financial-industrial group may finance these leasing companies, or they may source financing with the guarantee of another member of the group.

Usually these leasing companies are not independent and are not primarily interested in expanding their client base or developing their business further. Although they may work with outside clients, the leasing conditions for “in-house” and outside clients can be quite different; for companies that are part of the same financial-industrial group, the commission may be minimal. However, despite the use of “non-market” leasing rates, these companies do not have a major influence on the competitive environment on the leasing market, as with outside companies they usually work under market conditions.

Some companies of this type develop as independent leasing companies over time, due to either experience, available funds from other sources, or simply opportunities available.
This may depend on the nature of the parent and the group ownership. RTK-Leasing is a case in point, as the company has diversified its funding base. The client base, although primarily composed of Rostelecom and related companies, is also unique, in that the operating companies of the Rostelecom/Svyazinvest group are controlled to varying degrees by the parent. RTK-Leasing also plays the role of ‘authorized agent’ for negotiations with foreign suppliers, a way of attempting to ensure that the group benefits from the best possible terms. Finally, we note that the ownership of RTK-Leasing is changing, and may yet become independent.

In the long term, we are very skeptical about the prospects for this part of the industry. We believe it will not prove practical for large groups to devote the time, management resources or group funds to such peripheral activities. To the extent that lease financing is needed, it will eventually make sense to source these services and funds outside the group. The continued existence of such leasing companies (in a way somewhat similar to the so-called ‘pocket’ or settlement banks) is more an indication of the undeveloped nature of the financial sector than of the logic of the business model.

Supplier-owned leasing companies (traditional captives)
This group of companies may also be split into companies owned by Russian suppliers of equipment (Sibmashleasing – the leasing company of Sibmashholding, Ankor, Dontrading – the Rostelmash leasing company) and companies owned by foreign suppliers of equipment – Caterpillar, Daimler Chrysler Service (debis), John Deere (Russia) and Hewlett Packard.

The aim of these companies is to promote the producers’ products on the market. In this case leasing is used as an additional sales mechanism. As a rule, these companies are differentiated by their extremely narrow specialization: either as regards the type of equipment and the sector (for example, Sibmashleasing works with agricultural equipment in the agrarian sector), or the type of equipment, for example – transport vehicles, but for various sectors.

Captive leasing companies often make considerable business sense, since the manufacturer (and its dealer network) is often in the best position to estimate the equipment risks, and in many cases also has specialized knowledge of its clients that other financial institutions would have difficulty replicating. We believe that captive leasing companies in Russia, both foreign and domestic, will play an increasingly important role on the market. Russian suppliers have a distinct disadvantage in this respect, as they often lack the financial resources of the foreign suppliers. More importantly, they lack the experience and knowledge of how to use leasing to increase sales and profits.

Government-owned leasing
Companies in this group can be divided into companies that operate on a commercial basis and those operating on a non-commercial basis. Leasing companies that are financed from regional (local) budgets receive financing for targeted activity, although they often enter into leasing deals primarily on a commercial basis, usually depending on the area of activity. Many of these companies were founded to support small businesses.
As examples we can name Moscow Leasing Company and the Irkutsk Business Park. These companies are partially financed by the local administrations, although they operate mainly on a commercial basis.

Another category of companies founded by government entities operate on a non-commercial basis. Interest rates on leasing deals at these companies are extremely low (often below inflation) and are not profit-driven; in many cases, they do not even preserve principal. The activity of these companies leads to serious market distortions which commercial leasing companies working in the same sector are affected by.

These distortions are not just seen in prices or interest rates. Some representatives from leasing companies believe that commercial leasing companies are experiencing difficulties attracting clients because potential clients are prefer to wait in the hope of receiving leasing deals with favorable (concessional) conditions from a “state operator.” Since the amounts of concessional financing available are limited, and the qualifying terms unclear, the result is a blockage in the relevant market.

When publishing our first report in 1998 we warned of this possibility, however, at the time the leasing market was so under-served that the presence of large state operators had no influence on the market situation.

Unfortunately, the good intentions of the state in this case have had the opposite desired effect. The economic analysis of the situation from the point of view of the lessee is straightforward, and no different than gambling. Unfortunately, if the ‘cost’ of waiting is less than the market-clearing cost of paying commercial borrowing rates, the otherwise productive equipment is not purchased. The end result is that Russian economic output is depressed, not increased. If the number of such cases is large enough, the perverse result of these subsidies may be the exact opposite of their intended purpose.

The other related problem is that such subsidies have not been well targeted. The most prosaic aspect of this problem has been that the subsidies are intended, particularly in the case of agriculture and aviation, to support both producers and consumers. Using lease financing has seemingly been the equivalent of aiming at two targets at once – neither target has been hit.

Many years of IFC experience in the international financial services markets shows that the granting of state subsidies in this way is far from the most effective means of supporting one sector of the economy or another. In this case, the aim of the state is to ensure financing for companies that would be refused by a bank. we believe that budget financing for leasing deals will not be a solution to the problem, and call for such financing – if

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37 This is particularly true if, as has often been the case, repaying such ‘government leases’ has been seen as ‘optional.’ To our knowledge, there have been few cases of repossession of government-leased agricultural equipment, which has only encouraged this perception.
it continues – to be provided at rates no lower than the market. Providing financing at no lower than the rate of inflation would be a reasonable starting point.

**Leasing companies set up by private individuals**

Of companies that participated in our research, 16% were formed exclusively by private individuals and at 29% more than half of the shareholders were private individuals. These are mainly regional companies, although some Moscow companies are also in this group. These companies vary widely with respect to the level of diversification of their types of equipment, sector and clients companies, which, as a rule, are small and medium-sized businesses. These companies usually work only in their region, as even a slight increase in overheads for a deal may make it unprofitable. The size of deals at these companies is not large (the average size does not exceed $20,000 and is frequently less), however the number of deals is significant – the majority of these companies entered into over 100 deals in 2001. From our interviews, we believe that some of these companies are amongst the most entrepreneurial; while their size may be small, their ability to maneuver quickly and be flexible adds depth to the market.

This type of regional leasing company is the very alternative financing mechanism that allows local small businesses to survive. The growth potential of these companies is restricted by lack of access to credit resources and their small amount of accumulated capital. While these players may be marginal in many respects, they contribute to the market, particularly in regions where other sources of finance are rare.

**CLASSIFICATION BY SIZE OF CLIENT COMPANIES**

All leasing companies operating in the Russian Federation may be divided into the following groups: those working mainly with small and medium-sized businesses, those working with large companies, and those working with all types of companies.

**Companies working with small and medium-sized businesses**

This group includes companies set up with the participation of business support structures, which are obliged to work with small and medium-sized businesses, and small regional companies that do not have the capital and borrowed funds to carry out large projects. We have already spoken of these companies earlier.

In this group, companies that stand out include Delta Leasing – a company set up with 100% foreign capital, and KMB Leasing – set up by KMB Bank, which are oriented to servicing small and medium-sized businesses; Moscow Leasing Company – the first leasing company in Russia specializing in small business; Irkutsk Business Park, the Tatarstan Small Business Leasing Company, and regional leasing companies whose activity is concentrated in a concrete region, district or city.

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38 The International Finance Corporation has provided funding to both Delta Leasing and to KMB-Bank, the parent of KMB-Leasing.
Companies working with large businesses
Usually this group includes leasing companies that are part of financial industrial groups, which use leasing as a means of reducing taxation or optimizing cash flow. In addition, large deals are carried out by leasing companies that have chosen to specialize with a particular type of equipment – for example, the leasing of aviation technology or equipment for heavy engineering. This group of companies in Russia is small, and this is confirmed by the results of our analysis: only 7% of the leasing companies surveyed work exclusively with large companies.

Companies working with any type of company
This group accounts for 38% of the total number of companies that participated in the survey. It includes companies that specialize in leasing general equipment, for example transport vehicles or computers. The procedure for leasing standardized equipment is well developed and these companies are noteworthy for their large number of deals.

Another type of company working with any type of business is leasing companies set up by banks. However, these still often prefer large projects – the ratio of preparation time and effort (fixed costs per deal) to expected revenues is more attractive.

CLASSIFICATION BY SIZE OF TERRITORY
Leasing companies may concentrate on working in one region or may work with lessees throughout Russia. For objective reasons (the enormous size of the Russian Federation) the majority of leasing companies work in the region where they are located. Entry into other regions requires the presence of regional partners. Of the leasing companies surveyed, less than 10% work with lessees from various regions. These include companies either set up by a bank with a large number of branches (RG Leasing) or as part of some sort of industrial group (RTK Leasing). Only a few ‘retail’ leasing companies attempt to operate in many regions, and even these companies do not achieve universal presence.

Concentrating on work in one region, a leasing company becomes totally dependent on the economic and political situation in this region. In addition, if a strong competitor appears in the region, the company may suffer. If a lessor decides to work with companies from various regions, it should take into consideration the unavoidable growth in overheads (payment of telephone bills, business trips by specialists, etc.). With a large number of deals, this may lead to a reduction in expected profit.

CLASSIFICATION BY SECTOR
The narrow specialization of sector-specific leasing companies is one of the key characteristics of leasing in the West, which has not arrived in Russia yet. This is partly due to the weak development of the secondary market for equipment. Key sectoral leasing companies work in agribusiness; however, these are mainly companies that use budget financing and operate on a non-commercial basis, as described above.
Leasing, as a financial instrument, has always played an important role in the economic development of countries that are members of the IFC. Countries with transitional economies often need to rapidly renew or invest in fixed assets so as to stimulate growth in production and adapt to the new economic environment. In situations where capital is insufficient, the process of renewing fixed assets may be sped up significantly by the active use of financial leasing. Leasing also helps small and medium-sized businesses, which form the economic basis of many developed countries, to get on their feet.

The IFC began its activity on the market for leasing in 1977. Since then the IFC has carried out 120 investment projects and 60 technical cooperation projects on the leasing markets in 35 countries. Total IFC investment in leasing projects to date amounts to approximately $1 billion. In many cases, IFC has established some of the first leasing companies, and founded (for example) what is still the largest leasing company in South Korea. To date, IFC has invested approximately $19 million in Russian leasing companies, and continues to look for more investment opportunities. For more information on IFC’s investment activities in other areas, please consult our web-site at www.ifc.org.

Investment in the leasing sector is often preceded by a technical assistance project. As part of this project, analysis is carried out of the legal and economic environment, based on which practical recommendations can be developed. Given the IFC’s experience of work in the area of leasing, the Russian government invited it to carry out technical assistance projects in Russia and to provide recommendations to improve the conditions for the development of the leasing market. The Leasing Development Group has carried out this work with the generous assistance of the government of the United Kingdom (in the first phase of the project) and the government of Canada, which is currently funding the LDG. There are currently two sub-projects working in the Russian regions, one in St. Petersburg and the other in Yekaterinburg, which are funded by the governments of Finland and the United Kingdom respectively.

There is currently a parallel project working in Central Asia funded by the government of Switzerland, and IFC plans to extend the experience of the Russian Leasing Development Group to other countries of the region. Although these projects work locally and adapt the approach to fit the local environment, they build on the experience acquired and lessons learned in Russia. In the fall of 2002, IFC will launch a project in Georgia to develop the nascent leasing industry there with the support of the Canadian International Development Agency.

The Leasing Development Group is one of the programs of the Private Enterprise Partnership (PEP), a program financed by the IFC and donor countries working in the countries of the former Soviet Union. For more information on PEP, please consult PEP’s website at www.ifc.org/pep.
IFC approach to investment in leasing companies
If the corresponding regulatory and legal conditions for the development of leasing are present, the next step for the IFC is to highlight a potential market and the most suitable mechanism for support from the IFC. Depending on the level of development of the leasing market, there are two possible approaches to the implementation of investment projects. If the leasing sector is at the initial stage of development, the Corporation may establish a new, independent leasing company with participation by foreign investors, technical partners (a large foreign shareholder with experience in leasing) and local partners. As soon as a company gets on its feet, the IFC acts more like a silent partner. Often the IFC provides debt financing, and sometimes straight equity or quasi-equity. If the leasing market is sufficiently developed, the IFC cooperates with existing leasing companies with either local or foreign investors.

When investing in a leasing company, the IFC generally limits its ownership stake to no more than 25%, and consequently acts as a passive investor and does not act as a manager.

Each of the sides in a joint venture carries out a particular function. The IFC may take on the initiative of developing the joint venture. It often also initiates an analysis of the leasing market, the development of concepts, the preparation of a feasibility study for the joint project and the identification of potential technical partners. With IFC cooperation, business plans are prepared, the operating policy of the joint venture is established and funds are mobilized to set the company up. Most often the IFC first invests in the charter capital of a new leasing company and then provides a loan. To help a newly established company, the IFC is ready to provide a loan, but only on condition that the other founders of the company also provide loans.

In the majority of under-developed leasing markets, it is important to have an active, focused and competent foreign technical partner with direct experience in leasing. To actively participate, the technical partner should have sufficient equity. This partner carries out the function of confirming regulations and operating procedures, and then ensuring that these are implemented; training local specialists, teaching them methods for carrying out leasing operations and managing companies. The foreign partner also consults on pricing and on a strategy in the area of marketing and administrative systems. As the IFC strives to set up local independent companies, special significance is placed on the training of personnel. In addition, the foreign technical partner should participate in the financing of company activity or help search for this financing.

The local partner provides organizational support and helps hire personnel as well as financing. The local partner also provides financial and marketing support through its network, if it is a bank, or through its client base, if it is a leasing company.

Components of management and financial policy of a joint venture
When implementing a joint project, the IFC recommends companies implement a balanced management and financial policy. Components of this policy include a high credit rating, control of the leasing portfolio, an upper limit for the number of contracts that
may be signed with one client, with companies from one sector or with one type of equipment. The financial policy includes a limit on the the ratio of debt to equity and recommendations for management to ensure that the leasing payment schedule in contracts corresponds with the schedule for its own loan payments to ensure liquidity. For example, the IFC reviews the following principles:

- limiting the ratio of debt to equity;
- the ratio of loans in foreign currency to loans in local currency (established based on a concrete project);
- limiting the size of the packet of contracts signed with one company or its divisions;
- the average length of a leasing contract should not exceed the periods for loans received by the company.

When investing in or lending to existing leasing companies (especially locally-owned companies), these same principles are applied. In addition, the IFC usually requires reports audited to International Accounting Standards, good diversification, strong equity, and looks for companies leading in their respective markets with good prospects for growth. Transparent ownership and good corporate governance are requirements for all IFC investments, and IFC only works with private companies (not government-owned entities). IFC generally does not credit through leasing companies for specific deals, as it prefers to finance a leasing company’s portfolio. Ideally, the targeted investment should be for $5 million or more.

**IFC investment in the Russian leasing sector**
IFC has invested to date approximately $19 million in four Russian leasing companies, and continues to look for more investment opportunities.

**Deutsche Leasing Vostok**
IFC investment activity on the Russian leasing market began in 1999 with the establishment of the leasing company Deutsche Leasing Vostok. Deutsche Leasing Vostok is a joint venture founded by the IFC and the German leasing company Deutsche Leasing. The charter capital of the joint stock company Deutsche Leasing Vostok amounts to $3 million, with 80% belonging to Deutsche Leasing and 20% to the IFC. In addition, the IFC provided the company with a loan of $3 million.

The company Deutsche Leasing Vostok, which was created after the Russian financial crisis in August 1998 when there was a significant drop in bank lending, was an important source of medium-term financing for the acquisition of equipment for Russian companies. Initially, the company’s clients were primarily branches of foreign companies, joint ventures and also large Russian companies. In the future, the leasing company plans to work with small and medium-sized businesses. Deutsche Leasing Vostok works with a broad range of equipment – construction, office and industrial equipment, and also vehicles.
Deutsche Leasing Vostok, the first general leasing company in Russia with a significant share of foreign capital, will help form a fully-fledged leasing market in Russia. At the moment the main problems in the leasing sector are insufficient funds for refinancing and also insufficient experience of risk management. In connection with this, the experience, leasing know-how and also the financial potential of the IFC and Deutsche Leasing, the oldest and largest leasing company in Europe, provides a reliable base for successful activity in Russia and the transfer of Western leasing technology to the Russian market.

**Delta Leasing**
In May 2002 the IFC provided Delta Leasing with a credit of $10 million for a period of four years. The borrower is the largest company in Russia providing leasing to small and medium-sized businesses in 20 Russian regions. The company is part of the investment group Delta Capital management/the U.S.-Russia Investment Fund (TUSRIF), which owns 100% of its shares. Delta Leasing has close relations with over 100 suppliers of imported equipment. By the beginning of 2002, the company had financed the purchase of equipment for over 200 clients, amounting to over $20 million. These clients represent over 20 various sectors of industry, from timber processing and furniture production to printing, packaging and food production.

This investment project was the result of IFC work to provide technical support for the development of the leasing sector in Russia. From the moment it was founded, Delta Leasing has actively cooperated with the Leasing Development Group in the area of training, consulting and also in the area of legislative initiatives. This IFC project is one of the many examples of how the Corporation’s activity in the area of technical assistance and its investment activity complement each other.

The credit line opened by the IFC for Delta Leasing will be an additional source of financing for the company’s leasing deals, as a result of which it will be able to support viable small and medium-sized businesses throughout Russia.

**Baltic Leasing**
In June 2002 the IFC decided to grant Baltic leasing a credit of $2 million for three years. These funds will be used to finance the most promising investment projects connected with the modernization of industry in the Northwest region.

Baltic Leasing was founded in 1990 and was the first private leasing company in Russia. The company’s main creditor is St. Petersburg’s Industrial-Construction Bank. In its 12 years of operations the company has carried out 300 leasing operations, and works with small and large companies including industrial, transport, shipbuilding and trade and catering companies. Leasing has been used to acquire ships, helicopters, trucks and cars, double-glazing production lines, pasta production equipment, bakery equipment, timber processing equipment and dental and printing equipment. The company has over 250 current leasing deals worth a total of $15 million. The IFC credit will allow Baltic Leasing to enter into leasing deals with conditions that are more advantageous to the lessee. The company will use the IFC credit line to expand cooperation with small businesses to renew their fixed assets and increase their competitiveness. The credit will also help im-
plement one of the areas of IFC strategy for the development of the financial sector in Russia, the strengthening of existing financial intermediaries and the creation of new ones.
PROFILES OF RUSSIAN LEASING COMPANIES

So that the reader has a better picture of the Russian leasing market, we have decided to provide more detailed information on a selection of Russian leasing companies.

These companies are typical representatives of various categories of leasing companies. They also demonstrate various approaches to leasing activity and the wide range of indicators characterizing the activity of these companies. Along with large companies like RG-Leasing and RTK-Leasing, the Russian market also has companies involved in a small number of deals, for example Siberian Leasing Company and Microleasing.

Unfortunately, in this section there are no leasing companies set up by suppliers of equipment, as part of a financial-industrial group, or state leasing companies working with the agricultural sector.

These profiles are provided as an information service, and are not intended to represent an endorsement of these companies or a recommendation.

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28 The profiles are drawn up based on information provided by the leasing companies themselves. The Leasing Development Group does not accept responsibility for the reliability of this information.
DELTA-LEASING

General Director:
Zinoviev, Nikolai Sergeievich

Contact person:
Shilin, Vyacheslav Valerievich

Contact information:
103051, Moscow, Malaya Sukharevskaya ploshad. No. 12
Tel.: (095) 960-2244
Fax.: (095) 960-2240
E-mail: anl@deltaleasing.ru
Web-site: www.leasing.ru

Legal form: Closed joint stock company

Company founded: 1999
Number of employees: 58
Audit by IAS: Yes

Founders:
Foreign investors – 100%

Charter capital: (rubles)
15,395,000

Types of equipment leased:
- production: 28%
- food processing: 18%
- telecommunications: 4%
- trading: 8%
- building installations: 3%
- printing: 20%
- printing equipment: 5%
- medical: 4%
- timber processing: 3%
- dry cleaning: 4%
- agricultural equipment: 5%
- transport passenger: 1%
- transport freight: 2%
- building installations: 3%
- production: 28%

Size of client companies:
Mid-sized, small

Geography of client base:
All regions of European Russia

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<thead>
<tr>
<th>Year</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>102</td>
<td>177</td>
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<tr>
<td>Number of leasing agreements per annum:</td>
<td>70</td>
<td>75</td>
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<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>69,330,000</td>
<td>114,321,000</td>
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<tr>
<td>Agreement size (rubles):</td>
<td>281,000</td>
<td>602,000</td>
</tr>
<tr>
<td>Minimum:</td>
<td>8,448,000</td>
<td>15,070,000</td>
</tr>
<tr>
<td>Maximum:</td>
<td>8,448,000</td>
<td>15,070,000</td>
</tr>
</tbody>
</table>
Delta Leasing is part of the financial group Delta Capital, which was founded in 1999 and which also contains the mortgage company Delta Credit and the commercial bank Delta Bank. The financial Group Delta Capital was set up by the U.S.-Russia Investment Fund, has capital of $400 million and has been implementing a number of projects in Russia since 1995.

In its entire history, the U.S.-Russia Investment Fund has carried out direct investment in Russia in over 30 companies with outstanding management, thereby helping them realize their commercial potential. Having realized the attractiveness of investment in the financial services sector, the Fund decided in 1999 to set up the financial group Delta Capital. “The first swallow” in the formation of the group was the establishment the same year of Delta Leasing.

Unlike other companies in the financial group, Delta Leasing began its activity in Rostov-on-Don, where representatives from the group invested in a small leasing company, later renamed Delta Leasing. Delta Capital supported the entrepreneurs carrying out this project by capitalizing the company and opening a credit line to expand leasing activity.

Six months after the start of Delta Leasing’s activity in Rostov-on-Don, the company had a liquid and high-quality portfolio of leased equipment. At the end of 1999, Delta Capital Management hatched a plan to expand their leasing business in Russia. Having received support, Delta Leasing opened offices in Moscow, St. Petersburg and Yekaterinburg. At the moment the company is working in over 20 Russian regions and is a large player on the market for leasing services for small and mid-sized companies.

Delta Leasing’s clients are companies involved in manufacturing and services, that have been successfully operating for not less than one year, producing competitive products and have a stable position on the market. The majority of client companies are small and mid-sized businesses. Accordingly, the company’s portfolio reflects the financial needs of this particular group of lessees: the average leasing contract size, based on the cost of the equipment, is 4.5 million rubles and the minimum size of a leasing deal is 602,000 rubles.

In 2001 the company entered into 75 leasing deals worth 114.3 million rubles. Delta Leasing clients mainly use the equipment leased to produce printed products that are the equal of their imported counterparts in terms of quality; packaging materials, used by large food and drink producers in the country; construction materials, successfully and broadly used to build modern buildings; high-quality foodstuffs produced from local ingredients; office and home furnishings, which are in great demand; and also to provide high-quality dental, auto-service and other services.

In 2002 Delta leasing received a four-year credit from the International Finance Corporation (IFC) of $10 million to finance leasing deals. These funds will be used by Delta Leasing to expand the sphere of services provided to small and mid-sized businesses.
RG-LEASING

General Director:  
Filyev, Andrei Anatolievich

Contact person:  
Samoilov, Vadim Vladimirovich

Contact information:  
117997, Moscow, ul. Vavilova, No. 19, Sberbank of Russia  
Tel.: (095) 424-7300  
Fax.: (095) 913-8756  
E-mail: RDLEAS@com2com.ru  
Web-site: www.SBRF.ru

Legal form:  
Closed joint stock company

Company founded:  
1993

Number of employees:  
27

Audit by IAS  
Yes

Founders:  
Financial institutions/banks – 90%  
Private individuals – 10%

Charter capital: (rubles)  
7,500,000

Types of equipment leased

Size of client companies:  
Large, mid-sized, small

Geography of client base:  
All regions of Russia

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
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<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>62</td>
<td>106</td>
</tr>
<tr>
<td>Number of leasing agreements per annum:</td>
<td>20</td>
<td>60</td>
</tr>
<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>95,000,000</td>
<td>216,000,000</td>
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<td>Agreement size (rubles):</td>
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<tr>
<td>Minimum:</td>
<td>1,000,000</td>
<td>240,000</td>
</tr>
<tr>
<td>Maximum:</td>
<td>60,000,000</td>
<td>100,000,000</td>
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</table>
Russian-German Leasing Company (RG Leasing) was set up in 1993. The company received a license to carry out leasing activity in 1996. Active participants in the founding of RG Leasing were Sberbank of Russia (55% of charter capital) and the Swiss finance company Jurasko Zurich AG (35%). Today 90% of charter capital belongs to Sberbank of Russia and 10% is distributed among private investors.

In the first years of the company’s activity, Sberbank of Russia was not only its main shareholder and creditor, but also the main client. However, the company implemented a targeted policy to gradually increase the proportion of deals with industrial and trading companies in its total investment.

Today the company’s clients include private and state companies in many Russian regions, involved in various areas of economic activity: the food industry, processing of agricultural products, printing, engineering, trade, freight transportation, pulp and paper production, the chemical industry, and others. This is reflected in the broad range of equipment leased by the company under current agreements. As of January 1, 2002 the company’s investment portfolio included 106 leasing agreements.

RG Leasing has established partnerships with a number of foreign and domestic suppliers of equipment, including well-known companies such as Daimler-Chrysler, Sandwick, Anton Olert, Man-Roland, Heidelberg, Ibris, Itrako, and Kh.G.S. Center.

The system established for cooperation with Sberbank of Russia, the company’s main creditor, helps to ensure the competitiveness of the leasing services offered. The company has the possibility of financing deals from $100,000 to several million U.S. dollars in any region of Russia. In addition, the period of effect of a leasing agreement may amount to up to five years. Based on the resource base of Sberbank of Russia, RG Leasing offers its clients mechanisms for implementing leasing projects with payments reflected both in foreign currency and in Russian rubles.

Many years of cooperation between RG Leasing and large Russian insurance companies such as Military Insurance Company, Ingosstrakh, SOGAZ Insurance Company and Zurich-Rus in the area of insuring property and financial risk, reduces risks on leasing deals and, accordingly reduces the cost of the leasing services themselves.

Since 1995 RG Leasing has been a fully-fledged member and Russian representative in the international Multilease Association. The Association unites leasing companies and financial organizations in over 50 countries around the world using the formula “one company – one country.” Participation in the Association helps companies provide financial products and a technology for work with clients, that meets international standards.
KMB-LEASING

General Director:
Cherkas, Mikhail Alexeivich

Contact person:
Nekrasova, Yulia Vasilievna

Contact information:
119121, Moscow, 1st Neopalimovsky per. No. 15/7
Tel.: (095) 967-6707
Fax.: (095) 967-3062
E-mail: leasing@kmb.ru
Web-site: www.kmbleasing.ru

Legal form: Closed joint stock company
Company founded: 2001
Number of employees: 13
Audit by IAS: Yes

Founders:
Financial institutions/banks – 100%

Charter capital: (rubles)
10,000

Types of equipment leased:

<table>
<thead>
<tr>
<th>Type</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Printing</td>
<td>28%</td>
</tr>
<tr>
<td>Trading</td>
<td>7%</td>
</tr>
<tr>
<td>Transport, freight</td>
<td>37%</td>
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<tr>
<td>Transport, passenger</td>
<td>10%</td>
</tr>
<tr>
<td>Food processing</td>
<td>6%</td>
</tr>
<tr>
<td>Production</td>
<td>12%</td>
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Size of client companies:
Mid-sized, small

Geography of client base:
Moscow, St. Petersburg, Ural, Eastern and Western Siberia, Far East, Volga region, Central region

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of current leasing agreements</th>
<th>Number of leasing agreements per annum</th>
<th>Total value of annual leasing agreements at acquisition cost of equipment (rubles)</th>
<th>Agreement size (rubles)</th>
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<tr>
<td>2000</td>
<td>8</td>
<td>8</td>
<td>16,100,000</td>
<td>Minimum: 420,000</td>
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<td>2001</td>
<td>8</td>
<td>8</td>
<td></td>
<td>Maximum: 6,285,000</td>
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</table>
KMB-Leasing was founded in 2001 and is a 100% subsidiary of KMB-Bank (the abbreviation stands for “small business lending” in Russian) – the only foreign bank in Russia that is completely oriented towards small and medium-sized enterprises. The main founder of KMB-Bank is the European Bank for Reconstruction and Development.

Like its parent company, KMB-Leasing specializes in working with small and medium-sized enterprises. Leasing deals carried out by the company differ greatly in size, from 420,000 rubles to 6.3 million rubles. The average size of a leasing deal is about 2 million rubles and the average period of a leasing agreement is 2.5 years.

In its first year of operations, the company entered into eight leasing agreements worth a total of 16 million rubles. Most of the company’s portfolio is printing equipment (28.4% of total portfolio value) and vehicles (36.8%). In addition, KOM-Leasing supplies packaging, construction and timber processing equipment and also photo labs, various food production lines and equipment for furniture production.

Financing of leasing operations is at present 100% provided by KMB-Bank. The company has 13 employees. Therefore to evaluate the creditworthiness of clients and for legal support and economic security KMB-Leasing frequently cooperates with its founding bank.

KMB-Leasing has regional offices in many large cities in Russia – Moscow, St. Petersburg, Samara, Togliatti, Nizhny Novgorod, Yekaterinburg, Chelyabinsk, Barnaul, Omsk, Novosibirsk, Tomsk, Krasnoyarsk, Irkutsk and Vladivostok. In the near future the company plans to expand the geographic range of its activity, and also the range of equipment leased. To expand its client base, the company uses a broad range of methods: its founder’s contacts, suppliers, and advertising in the mass media and on the Internet.
RTK-LEASING

General Director:
Kaplunov, Pavel Grigorievich

Contact person:
Asoyan, Karen Tadevosovich

Contact information:
129110, Moscow, ul. Schepkina,
No. 42, building. 2ф, Chaika Plaza Business Center
Tel.: (095) 777-0330
Fax.: (095) 777-0333
E-mail: RTC-Leasing@RTC-Leasing.ru
Web-site: www.rtc-leasing.ru

Legal form: Company founded: 1996
Open joint stock company

Number of employees: 66

Audit by IAS Yes

Founders:
Corporate entities – 100%

Charter capital: (rubles) 41,747,140

Types of equipment leased:

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transport, passenger</td>
<td>2%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>70%</td>
</tr>
<tr>
<td>Computers, and office equipment</td>
<td>25%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
</tr>
</tbody>
</table>

Size of client companies: Large, mid-sized

Geography of client base: Northwest, Western and Eastern Siberia, Far East, Volga region, Ural, South, Central region

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>150</td>
<td>179</td>
</tr>
<tr>
<td>Number of leasing agreements per annum:</td>
<td>36</td>
<td>29</td>
</tr>
<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>5,754,000,000</td>
<td>1,459,000,000</td>
</tr>
<tr>
<td>Agreement size (rubles):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum:</td>
<td>5,500,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Maximum:</td>
<td>200,000,000</td>
<td>120,000,000</td>
</tr>
</tbody>
</table>
RTK-Leasing was founded and received a leasing license in 1996. This leasing company was set up as part of the Rostelecom financial industrial group. RTK-Leasing is a member of the Russian association of leasing companies and has quite a large number of employees – 66 people.

RTK-Leasing was founded by corporate entities. The company’s main shareholders are Rostelecom – 27%, North-West Telecombank – 19%, Russian Industrial Bank – 16%, Gamma-Invest – 10% and Gamma Capital – 6%.

RTK-Leasing may be characterized as a specialized leasing company. Its operations are mainly concentrated in the leasing of telecommunications equipment (70% of the total value of the company’s portfolio). The company’s portfolio also contains computer and office equipment (25%) and also passenger transport vehicles (2%). The company entered into 29 leasing deals in 2001 worth a total of 1.459 billion rubles.

RTK-Leasing clients include mid-sized and large financial institutions and communications companies that need telecommunications equipment located throughout Russia. At the moment the company is actively cooperating with firms in the holding company Svyazinvest. The company finances leasing operations of from 300,000 rubles to 120 million rubles. The average size of the company’s leasing deals is 10 million rubles. Equipment is leased out for periods ranging from two to six years.

RTK-Leasing has a lot of experience of organizing project financing: since 1997 it has attracted bank credits amounting to over $300 million for periods of from six months to three and a half years, and has carried out two domestic bond issues.

RTK-Leasing also has wide experience of working with leading producers of communications equipment, which means that it can avail of the most advantageous conditions for the lessee when acquiring equipment.

The company’s specialization and also the identity of its founders means that RTK-Leasing can search for new clients using the contacts of its founders, equipment suppliers and other company partners.
SAKHALIN LEASING COMPANY

General Director:
Malashich, Alexei Vladimirovich

Contact person:
Shevchenko, Oksana Anatolievna

Contact information:
693007, Yuzhno-Sakhalinsk, prospect Mira, No. 119/_produkty
Tel.: (4242) 72-6622
Fax.: (4242) 72-6623
E-mail: salco@salco.ru
Web-site: www.salco.ru

Legal form:
Closed joint stock company

Company founded: 1996
Number of employees: 18
Audit by IAS Yes

Founders:
Corporate entities – 100%

Charter capital: (rubles)
22,400,000

Types of equipment leased:

Size of client companies:
Large, mid-sized, small

Geography of client base:
Far East

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of current leasing agreements</th>
<th>Number of leasing agreements per annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>112</td>
<td>50</td>
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<tr>
<td>2001</td>
<td>122</td>
<td>41</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>117,087,000</td>
</tr>
<tr>
<td>2001</td>
<td>268,212,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Agreement size (rubles):</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum:</td>
<td>600,000</td>
</tr>
<tr>
<td>Maximum:</td>
<td>78,346,000</td>
</tr>
</tbody>
</table>

Web-site: www.salco.ru
Sakhalin Leasing Company (SALCO) was founded in 1996. This is a general leasing company that provides equipment, technology and vehicles to companies in various sectors of the economy. The geographical range of the company’s activity is Sakhalin region and Khabarovsk territory. In 1998 the company opened a branch in Khabarovsk – Khabarovsk Leasing Center.

Sakhalin Leasing Company was founded by corporate investors, three Sakhalin companies. The company employs 18 people. In 2002 the company increased its charter capital, which amounts to 22.4 million rubles.

In five years of operations Sakhalin Leasing Company has carried out 170 leasing operations, having acquired unique experience of carrying out leasing operations, including financial, buy-back leasing and international leasing deals. Total investment by the company in the economy of Sakhalin region and Khabarovsk territory has exceeded 20 million dollars.

The company is the leader on the Sakhalin market for leasing services, accounting for over 70% of the total volume of deals carried out on the market in the period from 1996 to 2001. In 2001 the company entered into 41 leasing agreements worth a total of 268 million rubles.

The company’s leasing portfolio includes projects that cover various spheres of business - food processing, timber processing, services, medicine, transport, financial institutions, printing, the oil and gas industry and fishing. Leasing of ships accounts for 81% of the total value of the company’s current portfolio. The company finances leasing operations of from 600,000 rubles to 160 million rubles. The average size of the company’s leasing contracts is 5 million rubles.

The volume of the Sakhalin Leasing Company leasing portfolio generates sufficient funds to enable the company to invest in new leasing deals. The company also attracts debt funding from banks and other corporate entities and enters into staggered payment agreements with suppliers of equipment, and also issues securities.

Sakhalin Leasing Company’s clients are dynamically developing small, mid-sized and large businesses. One strategic area of the company’s development is the financing of large investment projects in various areas of the economy. The company is ready to consider investment projects of $50,000 and higher.
MOSCOW LEASING COMPANY

General Director:
Kolomeitsev, Vladimir Alexandrovich

Contact person:
Tkachenko, Mikhail Victorovich

Contact information:
113035, Moscow, ul. Bolotnaya, No. 12, building. 3
Tel.: (095) 234-5373
Fax.: (095) 234-5373
E-mail: mlc@binec.ru
Web-site: www.ml.ru

Legal form:
Closed joint stock company

Company founded: 1993
Number of employees: 37
Audit by IAS No

Founders:
Corporate entities – 100%

Charter capital: (rubles)
132,500,000

Types of equipment leased (based on results of 2001):

<table>
<thead>
<tr>
<th>Type of Equipment</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food Processing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timber-processing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport, passenger</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Printing</td>
<td></td>
<td>19%</td>
</tr>
<tr>
<td>Trading</td>
<td></td>
<td>2%</td>
</tr>
<tr>
<td>Transport, freight</td>
<td></td>
<td>59%</td>
</tr>
<tr>
<td>Other</td>
<td>5%</td>
<td></td>
</tr>
</tbody>
</table>

Size of client companies:
Mid-sized, small

Geography of client base:
Moscow, St. Petersburg, Volga region, Ural, Western Siberia, Central region

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>278</td>
<td>421</td>
</tr>
<tr>
<td>Number of leasing agreements per annum:</td>
<td>141</td>
<td>260</td>
</tr>
<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>82,546,000</td>
<td>251,245,000</td>
</tr>
<tr>
<td>Agreement size (rubles):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum:</td>
<td>86,000</td>
<td>53,000</td>
</tr>
<tr>
<td>Maximum:</td>
<td>9,533,000</td>
<td>16,225,000</td>
</tr>
</tbody>
</table>
The Moscow Leasing Company is the first leasing company to specialize in small businesses. The company is implementing a whole range of Moscow city programs to support small business, supporting sales by Moscow producers, developing regional and international relations, and social projects.

Set up in 1993 to support small business in Moscow, Moscow Leasing Company is today a well-known and authoritative organization. The company was one of the creators of special leasing legislation in Russia, as a founder of the Russian Association of Leasing Companies, the CIS Leasing Confederation, and a participant in the Moscow Chamber of Commerce and a co-founder of a number of Russian associations and leasing companies in the Russian regions. The company received a license to carry out leasing operations in 1996. The company employs 37 people.

Moscow Leasing Company’s activity covers the leasing of technological, food, trading, medical, printing and office equipment, transport vehicles, and construction technology. A separate area of the company’s activity is the so-called “turn-key leasing” or leasing of property complexes, including real estate and equipment to carry out production activity.

The company deals with inexpensive projects costing, as a rule, from $10,000 to $250,000. However, it also has more expensive projects worth millions of dollars. Company representatives work in an area stretching from St. Petersburg to Irkutsk. Trucks with the logo of Moscow Leasing Company may be seen on roads throughout Russia.

Moscow Leasing Company is unique as regards its possibilities and the resources available to it. Moscow government budget funds and also credit resources from Moscow banks, attracted to finance its activity, have allowed Moscow Leasing Company to form one of the largest portfolios, in terms of deals, on the Russian leasing market. At the end of 2001 the company’s portfolio contained 421 deals.

The company actively advertises its services in print mass media and on the Internet, and also uses suppliers’ contacts to attract new clients. The company is carrying out a lot of work in the area of education, exchange of information, consulting and leasing propaganda. Seminars, conferences, round-table discussions, and the publishing of the bulletin Leasing Review for a number of years – this is only part of the company’s activity in this area.
SIBERIAN LEASING COMPANY

General Director:
Moroz, Sofia Aronovna

Contact person:
Moroz, Sofia Aronovna

Contact information:
650004, Kemerovo, ul. Sobomaya, No. 6
Tel.: (3842) 35-4368
Fax: (3842) 58-7467
E-mail: sibico@mail.ru
Web-site:

Legal form: Open joint stock company
Company founded: 1996
Number of employees: 13
Audit by IAS No

Founders:
Private entities – 100%

Charter capital: (rubles)
110,000

Types of equipment leased:

<table>
<thead>
<tr>
<th>Category</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>Production</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Food processing</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Medical</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Timber processing</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Trade, transport</td>
<td>15%</td>
<td>19%</td>
</tr>
<tr>
<td>Video and household equipment</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Trade, transport</td>
<td>15%</td>
<td>19%</td>
</tr>
<tr>
<td>Computers</td>
<td>16%</td>
<td></td>
</tr>
<tr>
<td>Buildings</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>Office</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Production</td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>Food processing</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Medical</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Timber processing</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Trade, transport</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>Video and household equipment</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Trade, transport</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>Computers</td>
<td>16%</td>
<td></td>
</tr>
<tr>
<td>Buildings</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>Office</td>
<td>2%</td>
<td></td>
</tr>
</tbody>
</table>

Size of client companies:
Mid-sized, small

Geography of client base:
Western and Eastern Siberia

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
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<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>139</td>
<td>95</td>
</tr>
<tr>
<td>Number of leasing agreements per annum:</td>
<td>139</td>
<td>128</td>
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<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>7,841,600</td>
<td>12,516,000</td>
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<tr>
<td>Agreement size (rubles): Minimum:</td>
<td>4,800</td>
<td>7,200</td>
</tr>
<tr>
<td></td>
<td>Maximum:</td>
<td>646,500</td>
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</table>
The Siberian Leasing Company was set up in 1996 in Kemerovo using funds from private individuals. The company received a license to carry out leasing activity in 1997. Siberian Leasing Company’s clients include small and mid-sized businesses operating in Kemerovo and Novosibirsk regions and also in Krasnoyarsk and Altai territories. The company employs 13 people.

Siberian Leasing Company specializes in small leasing operations. The average cost of the equipment acquired for leasing agreements in 2001 amounted to 88,800 rubles. The largest contract was for 530,000 rubles.

The company’s portfolio included 965 leasing agreements at the end of 2001, spread out over a wide range of equipment and market sectors. The company leases printing, medical, timber processing, production, trading, and food processing equipment, freight transport vehicles, video equipment, photo labs, and buildings and installations. The average period of the company’s leasing agreements is 11 months.

Leasing deals are financed by bank credits and also loans from insurance companies and private individuals. Most leasing deals are entered into without the use of additional guarantees, therefore the company puts considerable emphasis on insuring equipment.

Siberian Leasing Company orients its activity towards a broad range of consumers. Therefore, along with using contacts of creditors, founders and suppliers, the company also actively advertises to attract new clients.

The company has established partnerships with many suppliers of equipment. Close ties with suppliers make it possible for the company to receive discounts and commercial credits when purchasing equipment. Siberian Leasing Company cooperates with suppliers of equipment to share risks – frequently leasing agreements contain guarantees of the return sale of the equipment to the supplier and also suppliers’ guarantees for the lessee.

Siberian Leasing Company is a small general leasing company that concentrates on working in its region and feels confident on the market for small leasing deals. The company has low operational costs and has established a diverse portfolio of leasing agreements.
RAIFFEISSEN LEASING

General Director:
Shabalin, Dmitry Vladimirovich

Contact person:
Oberauer, Peter

Contact information:
129090, Moscow, ul. Troitskaya, No.17/1
Tel.: (095) 721-9980
Fax.: (095) 721-1341, (095) 721-1342
E-mail: Leasing@raiffeisen.ru
Web-site:

Legal form: Limited Liability Company

Company founded: 2000
Number of employees: 13
Audit by IAS: Yes

Founders:
Foreign investors – 100%

Charter capital: (rubles)
8,600,000

Types of equipment leased:

Size of client companies:
Large, mid-sized

Geography of client base:
Moscow, St. Petersburg

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>14</td>
<td>150</td>
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<tr>
<td>Number of leasing agreements per annum:</td>
<td>14</td>
<td>136</td>
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<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>74,831,000</td>
<td>677,111,000</td>
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<tr>
<td>Agreement size (rubles): Minimum:</td>
<td>362,000</td>
<td>90,000</td>
</tr>
<tr>
<td></td>
<td>Maximum:</td>
<td>55,378,000</td>
</tr>
</tbody>
</table>
Raiffeisen Leasing is part of the Austrian Raiffeisen banking group and was set up in 2000 by the Russian bank Raiffeisen Austria (founded by Raiffeisen Zentralbank Oesterreich) – 50%, and the Austrian company Raiffeisen-Leasing International, which carries out the function of headquarters for the group’s broad network of leasing companies in Central and Eastern Europe, - 50%. A great advantage for Raiffeisen Leasing was the possibility of using the experience of the Raiffeisen group in leasing operations, accumulated over 30 years of work in Western Europe and 10 years on the markets in Central and Eastern Europe.

Raiffeisen Leasing is the first leasing company set up by a Russian bank with 100% foreign capital. It is a general leasing company involved in long-term and short-term financing for leasing of various types of equipment. The company’s main clients are clients of Raiffeisenbank and other large and mid-sized companies in the oil and gas, construction, food and telecommunications industries.

The company’s activity is concentrated mainly in Moscow and Moscow region, St. Petersburg and Leningrad region. The average period of a leasing agreement is from three to five years, with equal leasing payments. At the end of the leasing period, the equipment is transferred to the ownership of the lessee.

Leasing deals being carried out by the company differ greatly in size: from 90,000 rubles to 242 million rubles. The average size of the company’s leasing deals is about 5 million rubles. In 2001 the company entered into 136 leasing agreements worth 677 million rubles. The company’s portfolio is mainly made up of telecommunications (50.1% of total portfolio value), construction (14.1%) and computer (12.6%) equipment. In addition Raiffeisen Leasing leases production, printing, and agricultural equipment and also freight and passenger transport vehicles and various types of production lines for the food industry.

To finance its leasing operations Raiffeisen Leasing attracts credit lines from its founding banks, turns to outside Russian banks and also uses commercial credits from suppliers. The company uses the contacts of its founders and suppliers to expand its client base.
MICROLEASING

General Director:
Galakhova, Lyubov Victorovna

Contact person:
Galakhova, Lyubov Victorovna

Contact information:
196105, St. Petersburg, Moskovsky prospect, No. 79/6
Tel.: (812) 118-6980
Fax.: (812) 118-6980
E-mail: microleasing@vbi.ru
Web-site: www.vbi.ru

Legal form: Limited liability company
Company founded: 1999
Number of employees: 7
Audit by IAS: No

Founders:
Foreign corporate entities

Charter capital: (rubles)
100,000

Types of equipment leased:

- Transport 51%
- Office equipment 2%
- Medical 3%
- Production 17%
- Refrigerated trading equipment 16%
- Pavilions 2%
- Other 9%

Size of client companies:
Mid-sized, small

Geography of client base:
St. Petersburg and Leningrad region

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>63</td>
<td>66</td>
</tr>
<tr>
<td>Number of leasing agreements per annum:</td>
<td>39</td>
<td>31</td>
</tr>
<tr>
<td>Total value of annual leasing agreements at acquisition cost of equipment (rubles):</td>
<td>8,000,000</td>
<td>6,000,000</td>
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<tr>
<td>Agreement size (rubles):</td>
<td></td>
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</tr>
<tr>
<td>Minimum:</td>
<td>22,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Maximum:</td>
<td>799,000</td>
<td>587,000</td>
</tr>
</tbody>
</table>
The leasing company Microleasing is a project of the Volkhov International Business Incubator. Set up in 1995 at the initiative of the administration of the city of Volkhov and the Alliance of American and Russian Women, the Volkhov Business Incubator provides a range of services to small business – consulting support, supply of space and office services to budding entrepreneurs, and training in the main business skills. Financial support for entrepreneurs was initially supplied by the business incubator within the framework of a special leasing program. However with time, demand for leasing services in the region grew to such an extent that the need arose to set up a special structure to deal with this area. A separate organization was set up in December 1999 and registered as Microleasing. In February 2000 Microleasing received a license to carry out leasing activity and started to work independently in March.

Microleasing clients are mainly small businesses – corporate entities, farmers and also private entrepreneurs that have not established a corporate entity. The very name of the leasing company states in brief that it specializes in small deals. In 2001 the minimum value of equipment acquired by Microleasing under a leasing agreement was 35,000 rubles, and the average value did not exceed 192,000 rubles.

Microleasing entered into 31 deals in 2001 worth a total of 5.9 million rubles. Work with small companies dictates the specifics of the Microleasing portfolio: a significant part of the portfolio is accounted for by transport vehicles (51%), a large part – by refrigeration and trading equipment (16%) and production equipment (17%), with the remainder split between medical equipment, trading pavilions and office equipment.

The Microleasing central office is located in St. Petersburg. At the moment about 50% of the company’s portfolio, in terms of the number and value of the deals, is being implemented in the northern capital. The number of clients in Leningrad region is growing. Last year the company started to work with Vyborg and other cities.

Initially, the Volkhov Business Incubator’s leasing programs were financed by a USAID grant provided to set up structures to support small business. Then the U.S.-Russian Investment Fund opened a credit line for Microleasing for two years. Now Microleasing has its own funds, earned in the time since it started leasing activity, and also attracts debt funding.

The basis of Microleasing’s activity is to build partnership relations with the lessee. This is helped to a large extent by free leasing seminars held on a regular basis by the company. Microleasing also provides legal support for its lessees (consults on accounting, registers transport vehicles acquired with the State Inspectorate for Road Traffic Safety, etc.).
BALTIC LEASING

General Director:  
Korchagov, Dmitry Victorovich

Contact person:  
Zagarova, Anna Yurievna

Contact information:  
190031, St. Petersburg, Kanal Griboyedov embankment, No. 79/23  
Tel.: (812) 315-6407, (812) 312-9864  
Fax.: (812) 315-7726  
E-mail: mail@bl.spb.ru  
Web-site: baltlease.ru

Legal form:  
Closed joint stock company

Company founded:  
1990

Number of employees:  
26

Audit by IAS:  
Yes

Founders:  
Corporate entities – 73.33%  
Including: financial institutions/banks – 19.9%  
Private entities – 26.67%

Charter capital: (rubles)  
1,500,000

Types of equipment leased (consolidated information for ZAO Baltic Leasing and subsidiary OOO Baltleasing (St. Petersburg), founded in 1999):

Size of client companies:  
Large, mid-sized, small

Geography of client base:  
Moscow, St. Petersburg, Northwest, Ural region, South

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
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<tbody>
<tr>
<td>Number of current leasing agreements:</td>
<td>97</td>
<td>198</td>
</tr>
<tr>
<td>Number of leasing agreements per annum:</td>
<td>77</td>
<td>119</td>
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</table>
Baltic Leasing was set up in 1990 and was the first private leasing company in Russia. Baltic Leasing holds license No. 1 to carry out leasing activity, which was received by the company in 1996. The company employs 26 people.

Baltic Leasing shareholders are private and corporate entities, and St. Petersburg Banking House owns a significant share in the company’s capital. The company is one of the founders of the Russian and St. Petersburg Associations of Leasing Companies, and is also part of the holding company St. Petersburg Banking House. Baltic Leasing is participating in work to establish leasing legislation in St. Petersburg and in Leningrad region.

Initially, Baltic Leasing provided leasing services only to companies in the northwest region of Russia. However, now the geographical range of the company’s activity has expanded and it has started to work in Moscow, Krasnodar territory and Sverdlovsk region, through a network of branches and agents.

Baltic Leasing is a general leasing company. In its 12 years of operations, the company has carried out 300 leasing operations and works with both small and large clients – companies involved in industry, transport, shipbuilding and trade and catering. In 2001 the company financed leasing operations of from 220,000 to 38 million rubles. The average size of a leasing agreement amounts to 3 million rubles. The maximum current contract is for $6 million.

Equipment acquired under leasing agreements includes ships, helicopters, trucks and cars, window production lines, equipment for pasta plants and for the production of bread products, timber cutting benches, dental equipment, offset and flexographic printing machinery. In 2001 the company entered into 119 leasing contracts with an average period of 2.5 years for a total amount of over 308.5 million rubles.

The company finances leasing operations using its own funds, credits from the St. Petersburg Industrial-Construction Bank and also St. Petersburg Bank. The Baltic Leasing client base is mainly formed from the clients of creditor banks. To attract clients the company also uses the contacts of its founders, suppliers, advertising and also the Internet.

To effectively resolve the financial problems of its clients, the company has established close partnerships with suppliers of foreign and domestic equipment. In 2002 Baltic Leasing received a three-year credit from the IFC of $2 million to finance leasing deals. The IFC credit will allow Baltic Leasing to enter into leasing deals with conditions that are more favorable to the lessee.

The company’s auditor from 1998 was KPMG, and from 2001 – Pricewaterhouse Coopers Audit.
RUSSIAN LEASING LEGISLATION

INTRODUCTION

For leasing market participants, the most important event this year was undoubtedly the adoption of Federal Law No. 10 from January 29, 2002, “On Changes and Addenda to the Federal Law ‘On Leasing.’"

A clear and significant achievement of this law is the removal of contradictions between the law “On Leasing” and other legislative acts, particularly the Civil and Tax codes. In addition, internal contradictions were also removed and a number of new civil law regulations were introduced. The previous situation, in which parties could not be certain which of several different legislative acts took precedence, created considerable risks for all parties, and particularly for leasing companies. This higher risk reduced investments in leasing, and the removal of these contradictions should have a more significant effect on the leasing market than almost any other form of government support.

We will deal in detail with the most significant changes to the text of the law “On Leasing.”

An article has been removed from the text of the law “On Leasing” hereafter the Law, subdividing leasing into types: financial, operational and buy-back leasing. In addition, the understanding of operational leasing has been removed from the text of the Law, as it contradicts the Civil Code of the Russian Federation (which makes no distinguish between rent and operating leases). At the same time, despite legislators’ refusal to define buy-back leasing as a separate type of leasing in legal terms, in practical terms buy-back leasing is feasible as the possibility of combining the responsibilities of the supplier and the lessee within one leasing deal is retained in article 4 of the Law “On Financial Rental (Leasing).” These definitions in the Law were unnecessary and potentially problematic, as the Civil Code sufficiently defines the concept of leasing.

A number of provisions that contradict the Civil Code of the Russian Federation have been removed from the text of the Law. This mainly involves the conditions banning the combination of the responsibilities of debtor and creditor within a leasing deal, which in practice created problems in certain circumstances for leasing companies that required advance payments. Articles have been removed that restrict the term of a leasing agreement to the term of amortization of the property, and also an article granting the lessee the right to use the leased asset as collateral.

Article 13 of the Law has undergone significant changes, establishing a system for the undisputed seizure of the property. In addition, the new formulation of this article gives the lessor the right to demand the early dissolution of the leasing agreement and the return, within a reasonable period of time, of the leased asset to the lessor in cases covered by other legislation of the Russian Federation, the Law and the leasing agreement. Requirements have also changed for the undisputed transfer of funds from the account of the
lessee in the event of failure to make payments more than twice in succession. The amended version of the Law restricts this right to the amount of the overdue payments.

A whole range of new provisions have been included in the Law which, in our opinion, should also lead to an improvement in the legal restrictions on leasing contract law. This particularly applies to the reduction to three months of the period of time in which a review of the size of leasing payments is not permitted, which will allow more effective indexing, for example.

One other document capable of influencing the development of the market for leasing services is Federal Law No. 128-FZ from August 8, 2001 “On the Licensing of Various Types of Activity,” which cancelled the licensing of leasing. Although among leasing companies there are various opinions as to the advisability of this change, in our opinion the removal of the licensing requirement should have a positive effect. The system in effect earlier did not impose any particular requirements on leasing companies (whether of a financial or professional nature). In practice, this requirement was simply an additional bureaucratic barrier that prevented or slowed the entry of some firms into the market, and reducing investments through leasing.

Of course, requirements for the formation and amendment of the legislative base regulating leasing activity are not limited to the aforementioned legislative acts. Drafts of a new Customs Code and amendments to the Law “On Currency Regulation and Currency Control”, which are also of major significance to participants in leasing deals, are also being developed. However, the issue of seizing leased assets from unscrupulous lessees remains unresolved, as do other issues that will unavoidably require changes both in the Civil Code and the Civil-Procedural Code (and related legislation).

In the end, given the attention paid by the Russian government and the legislature to leasing, we can hope that these positive changes in leasing legislation are not the last.

**CIVIL-LEGISLATIVE REGULATION OF INTERNAL LEASING DEALS**

*Legal and Regulatory Base*


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\(^{39}\) As noted previously, it is important to keep in mind that the Russian terms “leasing” and “financial rental” are synonymous, although they are often misused. Throughout this text, we use leasing to refer to financial leasing (or capital leases) unless otherwise specified. “Rent” covers all forms of rent, of which financial leases are a sub-type. In addition, the determination of a financial lease is based on formal rather than substantive criteria. In most Anglo-Saxon countries and under International Accounting Standards, substantive criteria predominate. For these reasons, what qualifies as a financial lease in Russia may not qualify elsewhere, and vice-versa, although in practice there is considerable overlap.
In accordance with Chapter 34 of the Civil Code, financial rental (leasing) – hereinafter leasing – is a sub-type of the various types of rent defined. The provisions of Article 6 of Chapter 34 of the Civil Code apply directly to leasing and leasing legal relations are subject to the general provisions on rental, unless otherwise stated in this article.

The definition of a leasing agreement is given in Article 665 of the Civil Code. According to this regulation, under a financial rental (leasing) agreement, the lessor is obliged to acquire the property (asset) indicated by the lessee (from a seller named by the lessee) and to supply this property to the lessee in return for payment for temporary possession and use for entrepreneurial needs.

Based on this definition of a leasing agreement, we can establish the following qualifying factors of a leasing deal:

- Three-sided relationship – the seller (supplier), the lessor and the lessee are all participants.
- Broad freedom of contract with a minimum of two legal agreements. For a leasing relationship to exist, it is necessary to have two agreements – a sale (supply) agreement for the leased asset and a leasing agreement. In addition, the parties have the right to enter into an unlimited number of associated agreements. Associated agreements may include bank credit agreements, agreements ensuring that the parties meet their obligations (surety, collateral, bank guarantees), agreements dealing with work and services necessary to launch the equipment (installation of equipment), etc.
- The use by the lessee of the property for entrepreneurial purposes, i.e. for purposes aimed at the systematic earning of profit. In practice, this is generally a restriction on leasing directly to government and receiving additional tax benefits; government may still acquire the use of assets using ordinary rent. While some market participants would like to remove this restriction, it would be far less efficient and transparent for government to indirectly grant itself a tax benefit in this way.
- Acquisition of the property specifically for leasing. Based on these criteria, we can reach the conclusion that at the moment a leasing agreement is entered into, the leased asset may not be owned by the leasing company. Accordingly, the leasing out of property should be preceded by the acquisition of the property – the investment of funds in the leased asset. In addition, the choice of supplier and property should be made by the lessee, or the leasing agreement should state that the right of choice of supplier and property has been transferred to the leasing company. In practice, this restriction is not a major constraint, although it can create problems when leasing companies try to lease out previously-leased or repossessed assets. This problem can be resolved by selling and re-acquiring the asset. Since captive leasing companies are typically separate legal entities from the parent company, it causes few problems for industrial concerns that use leasing to boost sales.
Combining the responsibilities of supplier and lessee

Point 1 of Article 4 of the Law deals with the possibility of combining the responsibilities of supplier of the leased asset and those of lessee within one leasing deal. Previously, this type of legal relation was qualified as an independent type of leasing – buy-back leasing (or ‘lease-back’). Despite legislators’ refusal to classify this type of legal relation as a separate type of leasing, the legal nature of lease-back deals has not changed. As noted above, this definition was unnecessary.

Property, representing the leased asset under a leasing agreement

In accordance with Article 666 of the Civil Code, a leased asset may be any non-consumer good, except land and other natural objects. Under non-consumer good, civil legislation understands items that do not lose their natural properties (do not disintegrate, or change their appearance) during their use. Leased assets, for example, may not include raw materials or inputs, nor assets that are transformed during their use.

Certain types of restricted or prohibited assets may not be supplied as a leased asset, particularly equipment used to produce ethyl alcohol and alcoholic products.40

Leased assets may not include the results of intellectual activity (software, inventions, know-how, etc.) or most forms of intangibles, as they are not physical objects.

Term of a leasing agreement

Article 610 of the Civil Code and the new edition of the Law do not contain any specific requirements as to the period over which a leasing agreement may be entered into. However, establishing the term of a leasing agreement, the parties should keep in mind that entering into an agreement with a term significantly less than the period of the full amortization of the property may lead to the leasing agreement being declared a sham transaction.41

Essential conditions of a leasing agreement

In accordance with Article 432 of the Civil Code, a civil agreement, including a leasing agreement, is considered binding if agreement has been reached between the parties on all its essential conditions. According to legislators, essential conditions include conditions on the object of the agreement and also conditions indicated as essential in laws and other legal acts. In addition, either party theoretically has the right to identify a condition as an essential component of the agreement, although this has little effect in practice (or the party would simply not sign the agreement).

40 Point 6 of Article 8 of Federal Law No. 171-FZ from 22.11.1995 “On State Regulation of the Production and Sale of Ethyl Alcohol, Alcohol and Alcohol Containing Products.”
41 A sham transaction, according to Article 170 of the Civil Code, is understood as a deal entered into with the aim of hiding the nature of another deal, for example, a sale agreement with staggered payments.
Essential conditions of a leasing agreement are:

1. The object of the leasing agreement – information identifying the leased property.
2. The supplier of the property – if the lessee makes the choice of supplier, the agreement should indicate the supplier of the property; in the event of the choice of supplier being made by the lessor, the agreement should delegate the right of choice of supplier to the lessor.

In addition to the provisions named, we can highlight a whole range of conditions that for formal reasons are not essential, but omission of which may lead to conflicts between the parties.

These conditions may include the length of an agreement, the amount of leasing payments and a schedule for their payment. Theoretically, Article 1 of Chapter 34 of the Civil Code permits leasing agreements to be signed. However, the occurrence of such a situation in practice is unlikely. If the parties, for whatever reason, do not reflect these conditions in an agreement, we should note that the agreement will be declared valid for an indefinite period, which will allow an interested party to dissolve it, giving the other party one month’s warning or, with the leasing of real estate, three months warning before the dissolution of the agreement. Concluding a leasing deal that does not outline the basic characteristics of the deal is not likely to be in either party’s interests, so it is unlikely that either would sign such an agreement.

**Responsibility of the seller under obligations laid out in the sale (supply) agreement**

The responsibility of the seller under obligations that arise from the sale agreement are defined as the conditions of the corresponding agreement and the relevant statutes of the Civil Code, including sales issues (Paragraph 1 of Chapter 30) and supply (Paragraph 3 of Chapter 30), and in the event of the object of the agreement relating to real estate Paragraph 7 of Chapter 30.

Either the lessor or lessee may require the supplier to meet the terms of the sale agreement, as they have joint and several rights in this respect.\(^{42}\)

In addition, the lessee has rights and carries responsibilities placed upon the buyer by the law of the Russian Federation and the sale agreement, with the exception of the right to dissolve the agreement and the responsibility to pay for the property supplied. In other words, the lessee may demand directly of the supplier any redress (such as warranty repairs) without the involvement of the lessor – the ‘consumer rights’ are assigned to the lessee.

\(^{42}\) In accordance with Article 326 of the Civil Code, any joint and several creditor has the right to make demands in full of the debtor.
Responsibility of the lessor under obligations connected with the supply of property

In the event of non-fulfillment (improper fulfillment) of the seller’s (supplier’s) obligations, the responsibility of the lessor before the lessee depends on which of the parties to the leasing agreement chose the supplier.

If the seller was chosen by the lessee, the lessor is not responsible for the supplier meeting obligations under the sale agreement, unless stated otherwise in the leasing agreement.

If the seller was chosen by the lessor and fails to meet its obligations, the latter is jointly and severally answerable, together with the supplier, before the lessee,\(^{43}\) for fulfillment of its obligations under the sale (supply) agreement.

In addition to the situation mentioned, the lessor carries responsibility before the lessee if the supplier does not keep to the delivery schedule, or the delay is caused by circumstances for which the lessor is responsible. A clear example of this situation is the untimely transfer of funds as payment for the asset (where this causes a delay in delivery). This circumstance is grounds for the dissolution of a leasing agreement in the courts or on a unilaterally basis, where this procedure has been specified in the agreement (Point 3 of Article 450).

Leasing payments

The size, method and frequency of leasing payments is established by agreement between the parties and documented in the leasing agreement.

A leasing agreement may involve cash or non-cash forms of settlement. If settlements are to be made in cash (at the moment the upper limit for settlements in cash between corporate entities for one deal is 60,000 rubles), the parties need to take into consideration that payments made in cash are subject to a sales tax of up to 5% (sales tax is a regional responsibility, so the amount will vary by region).\(^{44}\)

The parties, by mutual agreement, have the right to provide for revising the size of leasing, for example, based on some externally-linked interest rate. However, the leasing payments may not change more often than once every three months.\(^{45}\) Note that this does not apply to foreign-currency linked leasing schedules, where payment is made in rubles based on a given exchange rate (such as Central Bank rates) at the time of payment.

Violation by the lessee of the payment schedule will result in the latter being responsible under Russian legislation or the conditions of the leasing agreement. In particular, the

\(^{43}\) In accordance with Article 323 of the Civil Code, with joint and several responsibilities of the debtors, the creditor has the right to demand part of the debt or the debt in full from both or either one of the debtors.

\(^{44}\) Central Bank of Russia directive No. 1050-U from 14.11.2001.

\(^{45}\) Article 27 of the law “On Financial Rental (Leasing).”
lessee may be charged a forfeit (penalty) and losses caused by the late payment. In addition, not keeping to the schedule for leasing payments may be grounds for the early dissolution of a leasing agreement or the undisputed transfer of funds.

**Right of ownership of leased asset and risk of accidental destruction**

In accordance with Article 11 of the Law, the leased asset is the property of the lessor throughout the term of the lease, and the right of use is granted to the lessee. At the end of the lease term, the right to own and use the property passes to the lessee in full, unless otherwise stated in the leasing agreement. In practice, most lease agreements specify the disposition of ownership and usage rights at the end of the lease term (usually by transfer or sale to the lessee, sometimes on an optional basis).

Despite the fact that the right of ownership is retained by the lessor for the entire period of the leasing agreement, the lessee is responsible for keeping the property out of harm and risks connected with the destruction, loss, damage, theft, premature breakage, errors made during installation and use, and other property risks from the moment the leased asset is accepted, unless otherwise stated in the leasing agreement.

**Financial control and control of use of leased asset**

As the owner of the leased asset, the lessor has the right to monitor the use of the property, the implementation of the conditions of the leasing agreement, and also to financially monitor the activity of the lessee connected with the leased asset and the implementation of the lessee’s obligations under the leasing agreement. In particular, Article 37 of the Law deals with the obligation of the lessee to ensure unhindered access to financial documents and to the leased asset.

A mechanism, schedule and other conditions for monitoring by the lessor should therefore be documented in the leasing agreement and in accompanying documents (see Article 37).

**Rights of lessee if the leased asset is sold to a third party**

The lessor, as the owner of the leased asset, has the right to alienate (sell), transfer as collateral or otherwise encumber it. In the event of ownership of the leased asset changing, irrespective of how the right of ownership to the leased asset passed to a third party, the leasing agreement – in accordance with Article 617 of the Civil Code – may not be changed or dissolved. This means that all the obligations of the parties as set down in the leasing agreement remain unchanged and the new owner is obliged to meet all the obligations taken on by the original lessor. This principle ensures the stability of civil turnover and protects the rights of the lessee, including those set down in the leasing agreement.

**Subleasing and transfer of lessee’s rights under the agreement**
With the written agreement of the lessor, the lessee has the right to transfer the possession and use of the property to a third party (subleasing). However, the lessee retains his responsibilities to the lessor.

A subleasing agreement may not be entered into for longer than the period of the leasing agreement.

Unless otherwise stated in the leasing agreement, in the event of the dissolution of a leasing agreement, the sublessee receives the right to enter into a leasing agreement for the property being used by him with the same conditions foreseen in the initial leasing agreement, but within the period of effect of the original leasing agreement.

In other respects, general provisions regulating leasing issues are applied to subleasing.

The lessee, with the agreement of the lessor, has the right to transfer not only the right of possession and use of the leased asset (while remaining the responsible party before the lessor), but also to transfer all rights and responsibilities under a leasing agreement to a third party (trans-rental). In this case the new party becomes responsible before the lessor.

In addition, in accordance with Article 615 of the Civil Code, the lessee may, unless otherwise stated in Russian law and with the agreement of the lessor, give the leased asset for free usage, transfer its rights under the leasing agreement as collateral and include them as a contribution to the charter capital of an economic association or company, or as a contribution to a production cooperative. However, since the lessee is not the owner of the asset, it cannot transfer ownership rights.

**Right to undisputed transfer of money (direct withdrawal from lessee’s account)**

According to Article 854 of the Civil Code, the undisputed transfer of funds from the settlement account of a client without legal proceedings is permitted in cases provided for by legislation.

The procedure and conditions for undisputed transfer of money from the account of a lessee are dealt with in Article 13 of the Law. According to this regulation, grounds for the undisputed transfer of funds include the non-payment by the lessee of more than two leasing payments in succession. The limit for the sum that may be claimed is restricted to the amount of leasing payments that have not been made.

The undisputed transfer of funds is carried out by the lessor sending a deposition to the bank in which the lessee has opened an account for the transfer of money directly from the lessee’s account.

The undisputed transfer of funds does not deprive the lessee of his right to turn to the courts.
However, we should not exaggerate the significance of the legal possibility of undisputed transfer of funds. In practice this right of the lessor is not always realized. Banks, for one reason or another, often delay implementing this demand or refuse to transfer the money. Although the leasing company has the possibility to appeal against the actions of the bank, the length of this procedure and the difficulty in proving the size of the sum to be recovered invariably forces the lessor to drop legal proceedings, since they are likely to prove ineffective. Leasing companies that are owned by banks, of course, have a distinct advantage in these circumstances – if the lessee’s accounts are serviced at the parent bank.

An additional guarantee for the leasing company may be the inclusion in the agreement of a requirement for the lessee to draw up an agreement with the bank dealing with the eventuality of undisputed transfer of funds. Such an agreement, in accordance with Article 854 of the Civil Code, is also grounds for the undisputed transfer of funds from the account of the debtor. In this case, the lessor is limited not to the amount of the overdue payments, as with the recovery of money in accordance with Article 13 of the Law, but to the amounts set down in the agreement between the bank and the lessee.

**Dissolution of the leasing agreement at the request of the lessor.**

**Repossession of the leased asset**

A system for the early dissolution of a leasing agreement at the request of the lessor is outlined in the Civil Code. Dissolution of a leasing agreement is allowed after legal proceedings (Point 2 of Article 450 and Article 619 of the Civil Code) or following the unilateral refusal to meet obligations in full or in part, when this refusal is permitted by law or by the agreement between the parties (Point 3 of Article 450 of the Civil Code).

**Court procedure for dissolving an agreement**

Under general regulations, the early dissolution of an agreement in the courts is allowed when there is a significant violation by the lessee of the conditions of the leasing agreement, or in other circumstances foreseen by law or in the agreement. As grounds (“significant violation”) for the dissolution of a rental agreement, and consequently a leasing agreement, Article 619 states cases when the lessee:

1. uses the asset with significant violations of the agreement or stated use of the asset, or with repeated violations;
2. significantly degrades the asset (damaging the asset);
3. misses a leasing payment deadline established in the lease agreement more than twice in succession;
4. does not carry out major repairs to the property in accordance with the schedule set down in the leasing agreement, and in the absence of such a schedule in the agreement, within a reasonable amount of time in those cases if such repairs are the responsibility of the lessee (in accordance with the law, other legal acts, or the agreement).
A leasing agreement may be dissolved in the courts in cases where the violation of the agreement is significant in nature, and also in other cases foreseen by the leasing agreement. These circumstances may include a one-off or two-time non-payment of the leasing payment or failure to make a full payment.46

In addition, grounds included in the agreement for its dissolution may be unconnected with violations of the agreement by the lessee, for example, the reconstruction or demolition of real estate that is the leased asset.

Regardless of this, on whatever grounds with which the lessor goes to the courts to request dissolution of the leasing agreement, the lessor is obliged to provide written warning of the need for the lessee to fulfill the obligations of the agreement within a reasonable amount of time.

Unilateral refusal to implement an agreement in the event of non-fulfillment of obligations by the lessee
Point 3 of Article 450 deals with the possibility of unilateral refusal to implement the leasing agreement in cases where this refusal is permitted by the agreement. Grounds for the unilateral refusal to meet obligations in an agreement may be foreseen as the grounds listed in Article 619 of the Civil Code, in addition to other conditions that are grounds for dissolving an agreement in the courts.47

CIVIL-LEGAL REGULATION OF INTERNATIONAL LEASING DEALS

Legal issues applied to international leasing deals
International leasing agreements are agreements where the lessor and the lessee are in different states. In this case, the location of the seller of the asset (the supplier) is of no significance. Under location, what is meant is the location of the corporate entity, but not its branch or representative office, even if it is registered or accredited on the territory of another state. Consequently, if a branch or representative office is participating in the leasing agreement, their location should be defined as the location of the corporate entity that founded them. In order to qualify a leasing agreement as an international leasing deal, the place of state registration (founding) of the supplier is not of significance.

General principles of choosing law that applies to international leasing deals
In accordance with Article 1201 of the Civil Code, the parties to a leasing agreement, in entering into the agreement or based on subsequent agreements, have the right to choose the jurisdiction which will apply to the leasing deal.

46 Supplements to Supreme Arbitration Court Information Letter No. 66 from 11.01.02 “Review of Practice in Resolving Disputes Connected with Rental.”
47 Supplements to Supreme Arbitration Court Information Letter No. 66 from 11.01.02 “Review of Practice in Resolving Disputes Connected with Rental.”
If the jurisdiction is not stipulated, the jurisdiction is deemed to be that of the country in which the "decisive party" to is located. For a leasing agreement, this party – in accordance with Article 1211 – is deemed to be the lessor.

In addition, the rights and responsibilities of the parties under a leasing agreement may be regulated by the provisions of the UNIDROIT Convention “On International Financial Leasing.” This Convention was drawn up in Ottawa in May 1988 and to date has been ratified by nine countries. In addition to Russia, which ratified the Convention in 1998, other participants include: Latvia, Belarus, Uzbekistan, Italy, France, Hungary, Nigeria and Panama.

In order for the Convention to be applied to an international financial leasing deal, one of the following conditions needs to be observed:

- the lessor, lessee and also the supplier (commercial company of the supplier) are in countries that are participants in the Convention;
- the leasing agreement and the agreement to supply the leased asset are regulated by one of the countries in the Convention.

The parties have the right to refuse to apply the Convention to a leasing deal. For this, it is necessary to include the corresponding proviso both in the leasing agreement and in the sale agreement.

UNIDROIT Convention and Russian leasing legislation

The majority of provisions of the Convention are reflected in legislative acts regulating leasing in Russian legislation. In addition, there is a range of provisions that are regulated differently in the Convention and in Russian legislation.

The most significant of these are:

- the absence in the Convention of buy-back leasing;
- according to the Convention, the sale agreement should be approved by the lessee insofar as it affects his interests;
- the Convention does not contain strict restrictions on the use of the leased asset for entrepreneurial purposes only. In addition, purposes are established for which the property may not be used – personal, domestic or family purposes of the lessee;
- the Convention and the Civil Code contain different definitions of the types of assets that may be a leased asset. According to the Convention, a leased asset may only be equipment (fixed assets, complex and other equipment), ruling out the possibility of supplying real estate under leasing, which is allowed under Russian law;
- in the Convention, the period of a leasing agreement is established based on the term of full amortization of the property or of its essential component;
• different approaches to the issue of the obligations of the parties in a leasing deal.

TAXATION OF INTERNATIONAL LEASING DEALS

Taxation accounting for non-residents

1. Registering with the tax authorities and receiving an Individual Tax Number
A non-resident leasing company is obliged to register with a tax office in the event that its activity in the Russian Federation is carried out through a branch, representative office or other remote sub-division (hereinafter – division).48

In addition, a leasing company is obliged to register in cases where real estate or transport vehicles are located on the territory of the Russian Federation, including those considered to be real estate by the legislation of the Russian Federation.

2. Registration with the tax authorities based on declaration, without receipt of an Individual Tax Number
In cases where a non-resident lessor is not registered with the tax authorities opens an account in a bank located in Russian territory, he is also obliged to register with the tax authorities.

In all other cases, registration of a lessor is based on a declaration supplied to the tax authorities and to the Tax Ministry in the place where the movable property or the source of payments is located.

Declarations are filed within a month from the moment the right to receive revenue or begin activity arises. For leasing activity, this is the date of the first leasing payment or the moment a leasing agreement comes into force.

Profit tax

Taxation of non-resident lessors
Foreign leasing companies carrying out activity in the Russian Federation through a remote subdivision pay profit tax using the same mechanism as that for Russian corporate entities.

Leasing companies receiving revenue from sources in the Russian Federation and not carrying out activity in the Russian Federation through a permanent representative office are charged profit tax at the rate of 20%. In addition, tax is levied on the leasing company revenue, defined as the difference between the total amount of leasing payments and lessor expenditure connected with the acquisition of the leased asset.49

48 The system for registering a non-resident leasing company with the tax authorities is set down in the Statute “On the Peculiarities of Registering Non-Resident Organizations with the Tax Authorities.”
In accordance with Article 301 of the Tax Code, responsibility for calculating and paying profit tax is borne by the entity paying the revenue to the non-resident lessor, i.e. the lessee. Payment of tax is carried out upon the transfer of each leasing payment in the currency in which the payment is made.

**Taxation of resident lessors**

Russian leasing company revenue from the transfer of property to a non-resident is subject to profit tax based on the general regulations set down in Article 25 of the Tax Code of the Russian Federation. In addition, the amount of tax paid by a Russian leasing company in accordance with the legislation of foreign states is taken into consideration when paying the last tax payment in the Russian Federation. The amount of tax taken into consideration, which was paid outside of the Russian Federation, cannot exceed the amount of tax due to be paid by this organization in the Russian Federation.

**Property tax**

In accordance with Article 2 of Law No. 2030-1 from December 13, 1991 “On the Taxation of Corporate Property,” in cases where the leased asset is registered on the balance sheet of the non-resident lessor, the lessor pays Russian property tax unless otherwise specified in a relevant (“double taxation”-type) tax treaty (signed by the Russian Federation). 50

If such an agreement or treaty exists, the following system for taxing the property of a leasing company is usually applied:

1. The tax on immovable property is paid in accordance with the legislation of the Russian Federation.
2. Taxation of moveable property depends on the presence in the Russian Federation of a permanent representative office of the leasing company. If this representative office exists, the moveable property is also subject to taxation on Russian territory.
3. If the leasing company does not have a representative office on Russian territory, taxation of the property covered in the leasing agreement is applied in the country in which the leasing company is a resident.

The basis for establishing the cost of the property for taxation purposes is the residual value, calculated based on the initial cost, with depreciation taken into consideration. Depreciation is calculated in accordance with the legislation of the country of residence and may not exceed the following annual limits: buildings and installations – 5%, cars, office furniture and equipment, computers, information systems and data processing equipment – 25%, other property – 15%.

50 The majority of agreements to avoid double taxation signed by Russia regulate the issue of taxing the property of foreign corporate entities in the same way. The system encountered most frequently is laid out in this document.
Property tax is paid quarterly at rates set by the regional legislative (representative) bodies, which may not exceed 2% of the residual cost of the property per annum.

**Value added tax**

In entering into an international leasing agreement in which the lessor is a non-resident, VAT is charged twice\(^{51}\), first when importing the property into the territory of the Russian Federation and subsequently when making leasing payments.

As the system and conditions for paying tax differs in each of the cases listed, we will look at each of them.

**VAT when bringing a leased asset through the Russian customs border**

*Customs VAT when importing a leased asset into Russia*

In accordance with Point 5 of Article 164 of the Tax Code of the Russian Federation, when importing assets under a leasing agreement, VAT is paid at the rate of 20 percent of the taxable base, calculated as the total customs value of the property subject to the payment of customs and excise duties (for goods subject to excise duties). The deadline for paying the tax depends on the customs regime applied.

The erroneous formulation used in Article 171 of the Tax Code, according to which tax deductions in the amount of VAT paid when bringing goods onto the territory of the Russian Federation are carried out in relation to “goods acquired,” has led to difficulties arising in some Russian regions with the reimbursement (offset value) of the total VAT paid when importing the property into Russia. The tax and customs authorities sometimes refuse to reimburse (offset) VAT paid when importing the leased asset onto Russian territory based on the argument that leasing the asset (acquiring rights of possession and use) does not amount to “acquiring” the asset; they interpret acquisition to be equivalent only to ownership. At the same time, Article 172 of the Tax Code, which establishes a mechanism and conditions for the application of tax deductions, does not tie the right to tax deductions to ownership rights to the imported property.

Until corresponding amendments are introduced to the Tax Code of the Russian Federation or an instruction or clarification from the tax authorities is issued, it is advisable to petition for a preliminary explanation on the possibility of the return (deduction) of customs VAT from the regional departments of the Russian Tax Ministry (which will be sufficient to request reimbursement).

In addition, the tax authorities inconsistently interpret the possibility of reimbursing (offsetting) VAT in cases where the property is included on the balance sheet of the non-resident lessor. This situation also requires an explanation from the regional tax authorities.

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\(^{51}\) Given the legislative possibilities of returning (deducting) VAT paid when importing property into Russian territory and as part of leasing payments, it would not be accurate, in our opinion, to speak of the double taxation of an international leasing deal.
The obligation to pay customs duties and taxes in accordance with the conditions of the leasing agreement may be borne by the non-resident lessor also. In this case, in accordance with Point 4 of Article 171 of the Tax Code, the total amount of tax paid by the non-resident taxpayer, on condition that the property is being imported for production purposes or to carry out any other activity of the tax payer - is subject to deduction or reimbursement.

In order to establish the right to have VAT paid by the non-resident deducted (reimbursed), participants in the leasing agreement should adhere to the following conditions:

1. the tax agent (here, the resident lessee) should pay VAT, deducted from the lease revenues of the lessor;
2. the property imported in accordance with the leasing agreement should be used for the provision of services by the lessee-tax agent;
3. the lessor should register with the tax authorities of the Russian Federation.

**Customs VAT when exporting the leased asset from the territory of the Russian Federation**

When transporting a leased asset through the Russian customs border in accordance with an agreement in which the lessor is a Russian leasing company, the property is not subject to taxation, as specified in Article 146 of the Tax Code.

**VAT on leasing payments**

*a) paid by the resident*

In cases where a non-resident leasing company carries out its activity on the territory of the Russian Federation through a resident division, VAT is paid using the mechanism in place for Russian corporate entities.

In cases where a non-resident leasing does not have a division on Russian territory, the obligation to pay VAT on the leasing payments is borne by the lessee who acts as the tax agent. The Tax Code of the Russian Federation places the following responsibilities on the tax agent:

- establishing the taxable base;
- calculating and deducting the appropriate tax from the total leasing payments to be transferred to the leasing company;
- transferring the total amount of tax to the budget, against funds due to be paid by the leasing company.

In accordance with Point 4 of Article 164 of the Tax Code of the Russian Federation, VAT is calculated at the rate of 16.67%, but the amount taxed is the total amount of the leasing payment due to the non-resident leasing company. Tax is paid where the tax agent
is located. This 16.67% on the total amount of the leasing payment including 20% VAT corresponds to 20% added to the pre-tax leasing payment.\textsuperscript{52}

To avoid subsequent conflicts with the lessor, it is advisable to address the issue of taxation of leasing payments in an international leasing agreement and to include the corresponding provision in the text of the agreement by specifying the tax procedures.

Article 171 of the Tax Code of the Russian Federation provides the lessee with the right of reimbursement (deduction) of VAT paid while meeting the obligation of the tax agent. The lessee receives the right to apply tax deductions only if the following condition is met: the lessee deducted and paid VAT on the revenue of the non-resident leasing company.

\textit{b) paid by the non-resident}
Non-resident lessors, in accordance with the Tax Code of the Russian Federation, are not subject to VAT; as explained above, the tax treatment is equivalent, but the lessee serves as the tax agent.

\textbf{Currency regulation of leasing deals}

Article 34 of the Law “On Financial Rental (Leasing)” contains a whole range of provisions (not requiring the permission of the Russian Central Bank) dealing with a beneficial mechanism for carrying out currency operations connected with leasing deals.\textsuperscript{53} However, according to Article 141 of the Civil Code, the mechanism for carrying out deals with in foreign currencies is established in accordance with the Law “On Currency Regulation and Currency Control.” This Law, in turn, puts the issue of establishing a system for carrying out currency operations connected with the movement of capital in the jurisdiction of the Central Bank of the Russian Federation.

Consequently, in considering international leasing deals, one should be guided by the provisions of the Russian Central Bank, which currently provide for a mechanism largely identical to the mechanism foreseen in Article 34 of the Law “On Financial Rental (Leasing).”

Currency regulation issues that arise as part of leasing legal relations may be divided into three groups.

The first group includes issues connected with payments under a credit agreement (loan agreement) in which the borrower is a resident leasing company, and the creditor (lender)

\textsuperscript{52} In other words, for a $1000 (pre-VAT) leasing payment, VAT equals $200 and this amount is remitted to the authorities. For an international deal, the lessor should round up the amount collected to include VAT, and the post-tax leasing payments equal $1,200. The lessee then withholds 16.67% of this amount, and remits $200 to the tax authorities. Hence the tax treatment is identical so long as the lessor calculates the amount of VAT that the lessee is required to withhold.

\textsuperscript{53} Note that these sections do not apply to domestic leasing deals in which payments take place in rubles, but the ruble payment is linked to a foreign currency. These are not currently the subject of currency regulation (although the separate sale or supply agreement may be).
is a non-resident. The second group deals with issues connected with settlements under a sale (supply) agreement where one of the parties is a non-resident; and the third group, with issues connected with settlements under a leasing agreement. We will look at these groups more closely.

1. Credits (loans) received by residents from non-residents

a) Credits (loans) of less than 180 days
The receipt by residents of credits (loans) for up to 180 days, in accordance with the Law “On Currency Regulation and Currency Control”, is considered an operation not connected with the movement of capital, and is carried out without any restrictions imposed by the Central Bank.

b) The receipt by residents of credits and loans from non-residents in foreign currency of over 180 days
The receipt of credits and loans of over 180 days, in accordance with Central Bank Directive No. 1030-U of September 10, 2001, “On a Mechanism for Implementing Currency Operations Connected with the Receipt and Return by Resident Corporate Entities of Credits and Loans in Foreign Currency Provided by Non-Residents for Periods of over 180 Days, and on the Abolition and Amendment of Certain Regulatory Acts of the Central Bank of Russia”, is carried out using an informatory mechanism. The informatory mechanism deals with the possibility of attracting credits and loans in foreign currency for periods of over 180 days without permission (license) from the Central Bank of the Russian Federation, on condition that documents required by the normative acts of the Central Bank are submitted to an authorized bank.54

2. Settlements arising from a sale (supply) agreement for the leased asset

Currency operations connected with the movement of capital and, consequently, carried out based on permission (license) from the Central Bank of the Russian Federation include crediting of the supplier (advances, preliminary payment) for a period of over 90 days. In addition, operations connected with the movement of capital apply to payments provided to the buyer staggered by more than 90 days. In these cases the leasing company is obliged to obtain the corresponding permission (license) from the Central Bank of the Russian Federation, supplying documents set down in Letter No. 12-524 of the Central Bank of the Russian Federation from October 10, 1995.

In cases when the buyer has received a break in payments for a period exceeding 90 days, but the property is on Russian territory, permission (license) of the Central Bank of the

54 The list of documents to be supplied to an authorized bank is dealt with in Central Bank Instruction No. 101 from September 10, 2001.
55 In accordance with Central Bank Provision No. 152-P from September 17, 2001, preliminary payment (payment of advance) is carried out without the permission of the Central Bank when importing airplanes and ships, internal waterway ships and space apparatuses, on condition that the these goods are supplied to the buyer not later than one year from the moment the preliminary payment (advance) is made.
Russian Federation is not required, regardless of the payment grace period provided.\textsuperscript{56} For these reasons and others, Russian leasing companies have a strong preference for taking delivery of equipment that has been customs-cleared by the supplier (or its agent) or working with a domestic supplier or distributor.

3. Leasing payments

\textit{a) Leasing agreement in which the lessee is a resident of the Russian Federation}

The Central Bank Provision No. 152-P from September 17, 2001 “On Changes and Addenda to the Central Bank Provision ‘On Changes to the Mechanism for Carrying out Certain Currency Operations in the Russian Federation’” No. 39, from April 24, 1996, established the following mechanism for carrying out settlements under rental and, consequently, leasing agreements. The resident lessee has the right, without permission (license) from the Central Bank, to make payments under a leasing agreement for leased moveable assets (i.e., except real estate and securities), and also airplanes and ships. The only condition for the application of this regime is the supply to the lessee of the leased asset no later than 180 days from the day of transfer (receipt) of the foreign currency, regardless of the period of the leasing agreement. In other words, the lessee may provide an advance to a non-resident leasing company without a license so long as the asset is delivered no later than six months after the first payments.

Based on this provision, receipt by the resident of immovable property under a leasing agreement is not included in the list of operations that may be carried out without the permission (license) of the Central Bank of the Russian Federation. Accordingly, a special mechanism for carrying out currency operations connected with the movement of capital is applied to the leasing of immovable property, i.e., a system involving the compulsory acquisition of permission (license) from the Central Bank of the Russian Federation.

\textit{b) Leasing agreement where the lessee is not a resident of the Russian Federation}

A system for carrying out settlements under a leasing agreement where the lessee is a non-resident is also dealt with in Central Bank Provision No. 152-P from September 17, 2001. According to this provision, settlements under a leasing agreement for moveable property, airplanes, sea ships and internal waterway ships and also immovable property located on the territory of the Russian Federation is carried out without the permission (license) of the Central Bank of the Russian Federation.

\textbf{Repatriation by non-resident of leasing payments from Russia}

Non-residents may receive payment for equipment supplied to Russian lessees and leasing payments from Russian lessees both in foreign currency and in Russian rubles.

In cases where payment is made in foreign currency, residents transfer money from their accounts in authorized banks to the account of the non-resident in foreign banks. In cases

\textsuperscript{56} In accordance with Decree No. 02-94 of the Central Bank of the Russian Federation from April 24, 1996 on carrying out settlements.
where payment is made in Russian rubles, non-residents encounter the need to purchase foreign currency with the aim of then repatriating it abroad.

At the moment operations for non-residents to buy foreign currency are regulated by Central Bank Instruction No. 93-I from October 12, 2000 “On a Mechanism for Authorized Banks to Open Non-Resident Bank Accounts in the Currency of the Russian Federation and to Carry out Operations with these Accounts.” This Instruction states that non-residents have the right, without special permission from the Central Bank of the Russian Federation and without any restriction, to buy foreign currency on the internal currency market of the Russian Federation through authorized banks using funds from type-K ruble accounts. At the same time, using funds from type-N accounts to acquire hard currency is subject to significant restrictions, which are dealt with in point 3.8 of this Instruction.

Naturally, to repatriate foreign currency bought on the internal Russian market, in addition to a ruble account, a non-resident needs to open a hard currency account with an authorized Russian bank. The system for opening and the regime for managing these accounts are the same in principle for residents and non-residents. Foreign currency bought by the non-resident using funds from the ruble account is paid into this hard currency account, and from there is transferred to an account abroad, according to the instructions of the non-resident.

**Customs regulation**

The provisions of Article 34 of the Law “On Financial Rental (Leasing),” which involves a new customs regime, and Letter No. 01-15/14858 from May 24, 1999 “On the Application of Federal Law No. 164-FZ from October 29, 1998 ‘On Leasing’” have been declared to contradict the Tax Code of the Russian Federation and are not in effect. Consequently, in importing property onto the territory of the Russian Federation as part of a leasing agreement, the parties to the agreement should be governed by the regulations of the Customs Code of the Russian Federation (hereinafter the Customs Code), which has relevant portions still in effect.

**Importation of property, which is the object of a leasing agreement**

In accordance with the Customs Code, property that is the subject of a leasing agreement may be imported into the territory of the Russian Federation under a full import regime or a temporary import regime.

1. **Full import regime (Chapter 4 of the Customs Code)**
   Placing goods under a full import regime involves the constant location of the property on Russian territory without the obligation to remove it from this territory.

   In placing goods under this customs regime, the lessee (if the responsibility to pay customs payments is not placed, by the agreement, on the lessor) pays customs payments, VAT and excise duties (on goods subject to these) in one payment. Note that VAT is ap-
plied after any applicable duties. Obviously, for lessees this amount can be quite significant and prohibitive without additional financing.

The customs duty rates applied for importing goods onto the territory of the Russian Federation, have been confirmed by Government Resolution No 830 from November 30, 2001, “On Customs Duties in the Russian Federation and the Range of Goods Applicable in Carrying Out Foreign Economic Activity,” and amount to from 5% to 30% of the cost of the property being imported.

2. Temporary import regime (Chapter 11 of the Customs Code)
The up-front payment of all duties and taxes, the absence of available funds for the lessee and the high cost of borrowed funds significantly reduce the attractiveness of international leasing for Russian lessees. A way out of this situation may be to import the property under a temporary import regime.

A temporary import regime involves the possibility of using goods on the territory of the Russian Federation with partial exemption from the payment of customs duties and taxes and without the application of certain exceptional import measures (including potentially quotas or other trade measures).

Partial exemption involves monthly payment of customs duties and taxes in the amount of 3% of the total that would have been due had the property been imported under a full import regime.

One of the most significant restrictions with applying a temporary import regime is the period for which the property may remain under this regime. According to Article 71 of the Customs Code, the period of the temporary import regime is set by the customs authorities and may not exceed two years. For various categories of goods the State Customs Committee may apply an extended temporary import period. But, as the extension of the period of temporary import is carried out only after the expiry of the initial period, the risk that it will not be extended can make concluding such a lease agreement too uncertain to be practical. Upon the expiration of the period of temporary import, and on condition that the period is not extended by a new period, the property must be exported from the territory of the Russian Federation or declared under another customs regime (i.e., regularized or imported in most cases).

As already noted, the period of temporary import may be extended by the customs authorities. In the event of the regime being extended to two years and 10 months (34 months), there is an equalization of the amount of customs duties and taxes paid under the temporary import regime and the total taxes and duties that would have been due under a full import regime. This in turn, in accordance with Article 72 of the Customs Code, involves the automatic transfer of the property to a full import customs regime.

In placing goods under a temporary import regime, it is also necessary to take into consideration that State Customs Committee Directive No. 7702-r from July 3, 2001, states that in cases when temporarily imported goods are placed under a full import regime,
payments made during the temporary import regime are not returned, and payments are due under the new regime at the customs rate and currency exchange rate in place on the day the customs declaration from the freight is accepted with the declared customs regime. However, decision No. GKPI 2001-1876 from the Supreme Court of the Russian Federation from January 23, 2002, states that the provision from the State Customs Committee establishing this system has been declared invalid and will not cause any legal consequences. As a result, when temporarily imported goods are placed under a full import regime, the total customs payments paid during the temporary import regime should be taken into consideration by the customs authorities against payments due in the full import regime.

It is also necessary to note that the Russian government has developed a draft Customs Code, which includes the possibility of applying goods (that relate to main production funds) to the temporary import regime for a period of 34 months with partial exemption from payment of customs duties and taxes. However, one condition that should be met is that such goods should not be the property of the Russian entities using them on the customs territory of the Russian Federation.

**Import of property to be subsequently leased**

A leasing company, regardless of whether it is a resident or a non-resident of the Russian Federation, has the right to import property destined to be subsequently leased only in a full import regime. Restrictions on the import of this property under a temporary import regime are dependent on the provisions of Article 29 of the Customs Code of the Russian Federation, according to which the disposal of goods for which relief has been provided on customs payments is allowed with the permission of the customs authorities of the Russian Federation.

**Export of property from the territory of the Russian Federation**

**Export of property from the Russian Federation in cases when the supplier or the lessor is a resident of the Russian Federation**

Property that is the object of a leasing agreement may be taken out of Russian territory under a temporary export regime or a full export regime (Article 14 of the Customs Code of the Russian Federation). The regulations applied to the temporary export regime are the same as those for temporary import of goods. In cases where goods are exported under a full export regime, the goods are taken out of the customs territory of the Russian Federation without the obligation to import them into that territory. It should be noted that Russian customs legislation foresees the duty free export of means of production from the territory of the Russian Federation (there are no export duties on these types of goods).

The export of property under a sale agreement is carried out under a full export regime.

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57 The provisions dealt with do not cover situations when the period of the temporary import of the leased asset is extended to 34 months by the customs authorities.
**Return of leased asset to lessor**

If a leasing agreement, upon its conclusion, foresees the return to the lessor of the property that is the leased asset, the following mechanism for customs clearance of the property through the customs border comes into effect.

In returning a leased asset (taken out under a full export regime) to a Russian lessor, the leased asset may be brought into Russian territory by the leasing company under a reimport regime. This regime is implemented without charging customs duties and taxes. When applying a reimport regime, the goods should be brought into the customs territory of the Russian Federation within 10 years from the moment of their export and should be in the same condition in which they were when they were exported, except for normal wear and tear. When reimporting goods within three years from the moment of their export, the Russian customs authorities return the paid amount of export duties and taxes and the entity moving the goods returns amounts received as payments or as a result of other benefits provided when exporting the goods (the Russian Government may stipulate the charging of interest from the returned amounts at the rate of the Central Bank of the Russian Federation).

**Export of a leased asset from Russian territory upon the conclusion of a leasing agreement**

There are a number of technical issues connected with the export of a leased asset from Russian customs territory. A leased asset brought in under a full import regime may be exported only under a full export regime, which involves the payment of customs duties in accordance with Article 98 of the Customs Code of the Russian Federation. In practice, most leased assets, such as equipment, are not subject to any export duties; export duties and other export taxes primarily apply to natural resources.

In addition, under a full import regime, as in a temporary import regime, a foreign lessor does not have any real means of controlling the export of the leased asset, as all activity connected with customs procedures in Russian territory should be carried out by the entity that imported this property.

In customs legislation it would be expedient to provide lessors with the right to export the leased asset from the territory of the Russian Federation under a reexport regime, and also to develop a procedure giving the leasing company the possibility of exerting control over the export of the leased asset, regardless of who imported the property.

**Establishing the customs value of property**

Establishing the customs value of property brought into Russian territory under a leasing agreement continues to be one of the most significant problems connected with customs procedures for leasing operations. In practice the customs authorities frequently apply the method of “the value of the deal for the imported goods” to establish the customs value of the property. This means that to calculate the customs payment, the sum of all leasing payments is used, which, in addition to the cost of the property, includes the size of the
fees paid to the lessor, the financing cost and other services included in the leasing agreement.

Despite the fact that the approach of the customs authorities to setting customs value is changing (reserve or other methods of establishing customs value are applied), cases of the application of “the value of the deal for the imported goods” method are not exceptional.

Grounds for the inadmissibility of applying this method for calculating customs payments when importing a leased asset into Russian territory are provided by the provisions of Point 2 of Article 10 of the Law from May 21, 1993, No, 5003-1 “On Customs Duties.” According to this regulation, the method of “the value of the deal for the imported goods” may not be used if there are restrictions in relation to the right of the buyer to the goods being evaluated. For leasing, given that the lessee only receives the right of possession and use, these restrictions are more than significant. Moreover, Letter No. 07-11/12510 from the State Customs Committee from August 31, 1995 “On the Distribution of Materials” contains a direct instruction that this method is not applied to rental, and consequently, to leasing deals.

Consequently, in importing property into Russian territory in accordance with a leasing agreement, the method of establishing customs value foreseen in Article 18 of the Law “On Customs Duties” should be consistently applied. In practice, however, application has been very inconsistent, and this application can effectively kill many otherwise sound cross-border lease deals.

This method is also inconsistent with practices of the World Trade Organisation, and Russia will almost certainly have to change its approach to customs valuation during the course of its accession to the WTO. At present, there are several different proposals to write into law the appropriate customs valuation method for leasing, although in principle this important change requires only a different interpretation of existing legislation. To date, however, the State Customs Committee has not changed its overall approach.

**Antitrust regulation of leasing operations**

In accordance with Russian legislation, leasing operations are subject to antitrust regulation in certain circumstances.

In accordance with Article 18 of the Law of the Russian Federation from March 22, 1991 “On Competition and the Restriction of Antitrust Activity on Commodities Markets,” and with Article 16 of the Federal law of the Russian Federation from June 23, 1999 “On the Protection of Competition on the Financial Services Market,” in certain circumstances, when implementing a sale agreement for a leased asset and a leasing deal it is necessary to inform or receive preliminary agreement from the Antitrust Ministry or one of its regional branches.
It should be noted that antitrust regulation is applied to Russian corporate entities and, in some cases, to foreign corporate entities that are involved in activities on Russian territory.

Antitrust permission for leasing operations is possible by receiving preliminary agreement from the Antitrust Ministry of the Russian Federation before entering into a deal, or by informing the Antitrust Ministry of the Russian Federation after entering into a deal, depending on the value of assets of the participants in the deal. An application to receive preliminary agreement (or inform of a deal) should be submitted by the entity acquiring the leased asset, i.e. the lessor – under a sale agreement, and the lessee – under a leasing agreement.

From current antitrust legislation it is not clear in what way participants in a leasing deal may be informed of the interest ratio of the balance sheet value of the leased asset to the balance sheet value of the main means of production and non-material assets, and on the total balance sheet value of the assets of the counter party. Consequently, it is possible the corporate entity could be answerable for innocent actions.

To resolve the indicated problem, changes in antitrust legislation will be required, according to which an application to receive preliminary agreement (or to inform of a leasing deal) should be submitted by the entity whose balance sheet indicators make this deal fall under the control of antitrust legislation.

Notification to the Antitrust Ministry of the Russian Federation of a deal should be submitted in the following cases:

**Sale agreement for a leased asset:**

- the balance sheet value of the leased asset, which for the seller is a main means of production, exceeds 10% of the balance sheet value of the main means of production and non-material assets of the supplier; and
- the value of assets in the balance sheets of both the supplier and the lessor are within from 50,000 to 100,000, minimum wages inclusive.

**Leasing agreement:**

- the balance sheet value of a leased asset, which is for the leasing company a main means of production, exceeds 10% of the balance sheet value of the main means of production and non-material assets of the lessor; and
- the value of assets on the balance sheets of both the lessor and the lessee are within from 50,000 to 100,000, minimum wages inclusive.\(^{59}\)

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\(^{58}\) As a rule, new equipment is acquired for subsequent leasing, which is supplied by the producer. In this case the object of a leasing agreement for the supplier is not a main means of production and, consequently, this deal is not subject to antitrust regulation.
Notification should be submitted to the Antitrust Ministry of the Russian Federation within 15 days after the corresponding deal is entered into.

If the value of the assets of the supplier and the lessor (for a sale agreement) or the lessor and the lessee (for a leasing agreement) is more than 100,000 minimum wages, then it is necessary to receive preliminary agreement from the Antitrust Ministry of the Russian Federation.

Consequently, a significant number of leasing agreements are subject to antitrust regulation. In practice, this is a largely bureaucratic procedure that does not prevent many leasing deals, but creates unneeded overhead and limits financing. Some parties do perceive this as an added risk. In our view, this regulation serves almost no practical purpose, certainly almost none in the area of monopoly regulation, and inhibits investment.

The regulations for agreeing leasing deals with the antitrust authorities, in accordance with Antitrust Ministry letter No. NF/18661 “On the Application of Antitrust Legislation,” are not applied for buy-back leasing deals. Buy-back leasing deals are carried out without agreement from the antitrust authorities.

Currently there is a significant need to make changes in antitrust legislation, which would make it possible to establish the balance sheet value of assets taking into consideration not only the minimal wage and its multiples, but also the level of inflation.

**Antitrust legislation of leasing deals as a type of financial service**

Based on Article 3 of the Law “On the Protection of Competition on the Market for Leasing Services,” a leasing agreement is considered to be a deal for the provision of financial services. Consequently, leasing agreements fall under double antitrust regulation. Therefore, in entering into a leasing deal it is also necessary to be guided by the provisions of the abovementioned law and Russian Government Resolution No. 194 from March 7, 2000 “On Conditions of Antitrust Control on the Financial Services Market and on Confirming Methods for Establishing Turnover and the Borders of the Financial Services Market for Financial Organizations’ Services.” Not all leasing deals fall under double antitrust regulation, only cases involving acquisition as a result of one or several deals, connected with the assignment of rights, of over 10% of the leasing company’s assets.

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59 At the time of writing, the “minimum wage” for these purposes (there is a separate minimum wage for actual salaries) is 100 rubles or just over three dollars. The relevant lower limit (50,000 minimum wages) is 5 million rubles or approximately $160,000.

60 According to point 2.5 of the list of types of financial services subject to antitrust regulation and the composition of the assets of the financial organization, acquired under assignment of rights, to calculate the turnover of financial services (confirmed by Antitrust Ministry decree No. 467 from June 21, 2000) the financial services provided under the leasing deal not only include the leasing of the property, but the acquisition of the property to be subsequently leased. In our opinion, this position is an unfounded and contradictory regulation of this law.
Unfortunately, based on antitrust legislation, we cannot reach an unambiguous conclusion on what falls under acquisition of a financial organization’s assets as part of a leasing deal – supply for temporary possession and use of the leased asset, or the purchase by the lessee of the leased asset. Therefore, participants in the leasing sector should decide this issue independently or by receiving the corresponding written clarifications from the antitrust authorities.

The mechanism for receiving agreement depends on the size of charter capital of the leasing company. According to point 3.4 of the provision on mechanisms for granting agreement for the carrying out of deals connected with the acquisition of assets or shares (share in charter capital) of financial organizations (and also rights allowing the creation of conditions for business activity or to carry out the function of the executive body of a financial organization), applications are submitted to the antitrust authorities by the entity acquiring the leasing company assets.

Preliminary agreement from the Antitrust Ministry of the Russian Federation to enter into a deal should be granted when acquiring, under assignment of right of demand, over 10 percent of the balance sheet value of the assets of a leasing company, when the size of its charter capital exceeds 5 million rubles. All of the necessary documents are supplied to the federal antitrust authorities, which should inform participants in the deal of their decision within 30 days.

In cases where the size of the charter capital of the leasing company, whose assets are being acquired under assignment of right of demand, is less than 5 million rubles, the lessor informs the federal antitrust authorities of the fact that the deal has been carried out within 30 days of it being carried out.

This provision is also largely ineffective and irrelevant in most cases. The use of charter capital rather than equity is a clear example, since the charter capital of many Russian companies is not significantly higher than the minimum required by law. The lack of clarity simply creates additional risks without providing much in the way of anti-monopoly protection.

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62 Such wording is given in Article 4 of the RF Government Regulation 194 of 7.03.2000 and it differs to some extent from the wording given in the Federal Law “On Protection of competition on the Financial Services Market”
63 Enumeration of the documents to be presented is listed in point 2 Article 17 in the Federal Law “On Protection of competition on the Financial Services Market” and is irrefragable.
Legislation on the prevention of legalization (laundering) of revenue received by criminal means

In accordance with Federal Law No. 115-FZ “On the Prevention of Legalization (Laundering) of Revenue Received by Criminal Means,” leasing deals for amounts equal to or exceeding 600,000 rubles are subject to compulsory control from the Financial Monitoring Committee. In accordance with Article 7 of this law, the responsibility to provide information on the deal to the Financial Monitoring Committee lies with the leasing company. The lessor is obliged (no later than the working day following the day the operation is carried out) to provide the Financial Monitoring Committee with the following information: the type, date, amount and basis for carrying out the operation, general information on the lessee and the entity representing his interests in relations with the lessor. Provision of the property under leasing is understood as the completion of the operation, in accordance with Article 6 of this Law.

The information listed above is provided to the Financial Monitoring Committee in electronic form through communications channels or on a magnetic carrier. Upon agreement with the Committee, this information may be provided in written form. 65

In practice, we have not heard of too many problems with respect to this regulation.

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65 Point 5 of the Statute on submitting information to the Financial Monitoring Committee by organizations carrying out operations with money or other property (confirmed by Russian Government Resolution No. 254. from April 17, 2002).
TAXATION OF LEASING DEALS

Current taxation regime

In accordance with Point 1 of Article 1 of the Tax Code of the Russian Federation (hereafter the Tax Code), Russian legislation on taxes and charges is composed of the Tax Code and federal laws on taxes and charges passed in accordance with it.

Over the last year, several chapters of the Tax Code directly affecting leasing operations have been passed and enacted. These define the system for calculating and paying VAT (Chapter 21 of the Tax Code), personal income tax (Chapter 23 of the Tax Code), profit tax (Chapter 25 of the Tax Code), and sales tax (Chapter 27 of the Tax Code). The mechanism for calculating a number of taxes, for example taxes on revenue and on property, continue to be regulated by federal laws.

We are confident that the adoption of the new version of the Tax Code is a significant step in the development of the leasing sector, as the main aspects of the tax regime that were favorable for leasing have been retained. In particular, the most important aspects are the retention of accelerated amortization and the choice of which party’s balance sheet the asset will be carried on. The reduction of the profit tax rate should have a favorable effect on the activity of all companies, including potential lessees.

The establishment of these advantages in the Tax Code significantly reduced the uncertainty that existed earlier due to a number of contradictions in various legal and regulatory acts.

From the point of view of taxation, the main advantages of leasing compared with other ways of financing capital investment are:

- the flexible approach permitted for recording property that has been leased (choice of whose balance sheet on which the equipment is recorded),
- the full expensing of leasing payments by the lessee (reducing the taxable base for profit tax),
- the party to a leasing agreement that records the leased asset on his balance sheet has the right to apply a special acceleration depreciation ratio of up to 3 times the standard (as a result there is a reduction in the amount of profit tax paid by the leasing company in the first period of the deal being implemented and a subsequent reduction in profit tax).

The aforementioned provisions lead to a reduction in profit tax, as the lessee and the lessor reduce their tax profits. Of course, this has meaning only in cases where the company has profit and consequently pays profit tax.

1 At the moment this method of registering property, on the balance sheet of the lessee or the lessor, influences not only accounting records but also tax records.
Profit tax

Tax rate
At the moment the total rate for profit tax amounts to 24%. Of the total tax, tax calculated at the rate of 7.5% is paid into the federal budget, at 14.5% into the regional budget and 2% into local budgets.

Amortization and depreciation
Regardless of on whose balance sheet the asset is recorded, the initial cost of the leased asset is calculated as the total costs to the lessor to acquire, supply and bring the property to a condition in which it is suitable for use.

This means that in including the property on the balance sheet of the lessee, the initial cost for accounting purposes and for tax reporting will be different. For accounting purposes, the initial cost of the leased asset in this case will be the total amount of leasing payments.

According to Article 258 of the Tax Code, all assets subject to depreciation are assigned an a period of useful life. There is a total of 10 amortization groups.

According to Point 7 of Article 259 of the Tax Code, for fixed assets that are the object of a financial rental (leasing) agreement, the taxpayer has the right to apply a special ratio to the main amortization norm, but not higher than 3. An exception are fixed assets that are in the first, second and third amortization groups, in which case amortization is calculated using the modified declining balance method (which is based on a monthly rather than yearly declining balance calculation) without the accelerated depreciation. These amortization groups include mainly those assets which have useful lives of less than five years.

For taxation purposes, organizations have the right to choose one of two possible methods for calculating amortization, proposed by the Tax Code:

- the straight-line method (depreciation is calculated monthly as the product of the initial cost and the depreciation factor),
- the modified double-declining balance method (“non-straight-line” in Russian terminology) (the amount of amortization is calculated monthly as the product of the residual value and the depreciation factor). This method differs from the declining balance method in the use of the monthly residual value rather than the annual.

In applying the straight-line method, the monthly depreciation (K) for each asset is calculated using the formula:

\[ K = \text{initial cost} \times \text{depreciation factor} \]

2 The mechanism for paying profit tax is regulated by Chapter 25 of the Tax Code “Corporate Profit Tax.”
3 Regional legislatures have the right to reduce the tax rate on their share of profit tax to 10.5%.
4 Fixed assets are classified in accordance with Government Resolution No. 1 from January 1, 2002 “On the Classification of Fixed Assets, included in Amortization Groups.”
5 The only exceptions are buildings, installations and transmission equipment in the eighth amortization group (period of useful operation of over 20 years), for which only the straight-line method is used.
\[ K = \left(\frac{1}{n}\right)\times 100\% \]

Where \( n \) = the period of useful operation in months.

For the modified double-declining balance method, the monthly depreciation (\( K \)) for each asset is calculated using the formula:

\[ K = \left(\frac{2}{n}\right)\times 100\% . \]

For the modified double-declining balance method, upon reaching a residual value of 20% of the initial value, this amount is written off as amortization in equal amounts over the number of months remaining until the end of the period of useful operation. This means that according to the formulation of this method in the Tax Code for leasing, an acceleration factor of 3 for the modified double-declining balance method may be applied not for the entire amortization period, but only until a residual value of 20% if the initial value is reached.

When leasing cars and passenger minibuses with an initial value of over 300,000 rubles and 400,000 rubles respectively, the depreciation standard (taking the application of a ratio of up to 3 into consideration) is combined with a special coefficient of 0.5, i.e. the acceleration ratio for these transport vehicles comes to 1.5.

**Leasing payments**
Leasing payments, according to Article 264 of the Tax Code, are, for the lessee, recorded as production and sales expenses. In cases where the property is included on the balance sheet of the lessee, amortization of the leased property is expensed, in addition to the difference between the leasing payment and amortization (which in total amounts to the leasing payment).

Calculating expenses for the lessee when the property is included on his balance sheet differs for tax and accounting purposes.

If we make comparisons with the situation in place before the recent changes to the Tax Code, when the lessee recorded amortization (taking the application of an acceleration factor of up to 3 into consideration) as costs regardless of the size of the leasing payment in the reporting interval, costs included only amortization which could be both less or more than payments made. In addition, not all the equipment might be amortized during the period of a leasing agreement, in which case the remaining part is amortized without the acceleration ratio (which delays the inclusion in costs of expenditures made by the lessee under the leasing agreement).

**Interest Expense Deductibility**
Chapter 25 of the Tax Code sets down a method for deducting interest expenses that differs from the method that existed until 2002.
At the moment, regardless of the character of the credit or loan granted – investment or working capital – interest is included in an organization’s expenditure. Earlier, when acquiring fixed assets and taking loans this reason, interest was included in the costs of the leasing company only.

It should be noted that according to Point 1 of Article 269 of the Tax Code, interest is considered expenditure on condition that the interest rate does not differ more than 20 percent above or below the average level of interest charged on debt granted in the same reporting period under similar conditions.

In the absence of bonds issued in the same quarter under similar conditions, and at the choice of the taxpayer, the upper limit for interest that may be deducted is defined as the refinancing rate of the Central Bank,⁶ - increased by 1.1 times (plus 10%) when paying debts in rubles, and set as 15% for debts in foreign currency.

The Tax Code places a restriction on the inclusion of interest in spending for credits granted by foreign related parties (those directly or indirectly owning over 20% of charter capital), and in the event that the borrowed funds provided by this related party exceeds equity capital by more than 12.5 times (for leasing companies and banks, and 3 times for other entities). This restriction is intended to limit profit-transfer schemes where all taxable profit of the leasing company would simply be transferred offshore.

In this case the following mechanism is proposed to establish the amount of interest included in spending (limit of interest included as expenditure on controlled debt).

\[
\text{Amount of interest qualifying as expenditure} = \frac{\text{The amount of interest on the controlled debt}}{\text{The capitalization ratio}}
\]

The capitalization ratio is calculated as follows:

\[
\text{Capitalization ratio} = \frac{\text{Unpaid controlled debt}}{\text{Equity capital + share in charter capital}} / 12.5
\]

The positive difference between interest paid and the limit on interest, calculated using this method, is equated with dividends for taxation purpose and is subject to tax at the rate of 15%.

If unpaid debt is not controlled (not provided by a foreign creditor owning over 20% of charter capital), the above rule is not applied. In practice, this restriction is not a problem for companies paying market rates of interest to foreign related parties.

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⁶ At the time this review was written (July 2002), the refinancing rate amounted to 23%.
Taxation of losses from the sale of assets
In accordance with Article 268, losses arising from the sale of assets being depreciated are included as a separate expenditure of the taxpayer in equal shares within a period established as the difference between the period of useful life of this property and the actual period of its use. For example, if an agreement contains a buy-out cost for the asset that is lower than its residual value, the loss to the leasing company may not be used to immediately reduce the taxable base (the taxable base is reduced over the remaining period of useful operation and without the application of the acceleration ratio).

It should be noted that until 2002 there were different points of view on the possibility of including losses arising during the sale of property at less than residual value to reduce the taxable base from profit tax.

Value Added Tax (VAT)

The value added tax rate
The parties in a leasing agreement are usually subject to VAT. Leasing companies pay the tax at the rate of 20%. Most commercial entities also pay at the rate of 20%, although some taxpayers (agricultural cooperatives, for example) pay at lower rates.

Mechanism for calculating and paying VAT
Leasing payments are subject to VAT. VAT payable is established as the difference between the total taxes received from the buyer for goods (work, services) sold and the total amount of taxes paid to suppliers for goods (work, services) acquired. In other words, VAT paid is offset against VAT payable.

This means that for leasing, VAT payable is calculated as the difference between the amount of VAT received from the lessee and the amount of VAT paid when acquiring the leased asset.

The lessee, in cases where sales are subject to VAT (at a rate of 20%, 10% or 0%), records VAT paid as a tax deduction. In cases where the activity of the lessee is exempt from VAT (in accordance with Article 149 of the Tax Code), VAT paid as part of a leasing payment is expensed.

Participants in a leasing deal frequently find themselves in the situation where tax deductions exceed the amount of VAT paid from the sale. Frequently this situation arises with leasing companies at the initial stages of activity, where VAT paid when acquiring the leased asset exceeds VAT received (the up-front VAT paid can only be offset over the

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7 The system for paying VAT is regulated by Chapter 21 of the Tax Code “Value Added Tax.”
8 Organizations and individual entrepreneurs have the right to be exempted from carrying out the obligations of a taxpayer if for the three previous calendar months the amount of revenue from the sale of goods (work, services) by these organizations, not including tax and sales tax, did not exceed a combined total of 1 million rubles. Tax Code of the Russian Federation, Part 2, Article 145.
term of the entire lease agreement). In this case, the difference that arises in the initial period is reimbursed (deducted, returned) to the taxpayer.

In accordance with Article 176 of the Tax Code, within three calendar months this amount is used to meet obligations to pay taxes and charges due to the federal government. If, after the three-month period has expired, the organization has not been fully compensated its VAT by means of these deductions, then the difference should be returned. If the government does not meet its obligations, interest is charged on the amount to be returned at the refinance rate of the Central Bank. We should note that in practice, tax authorities frequently refuse to directly reimburse VAT, which may lead to leasing deals becoming more expensive. The practice of regional tax authorities can vary significantly, but in some regions the amounts are reimbursed without difficulty; regional leasing companies are the best sources of information in each region on this point.

Until end-2001, the situation with payments of value added tax for leasing deals caused a number of problems. In particular, when including the leased asset on the balance sheet of the lessee, the lessee often encountered the problem of accounting for VAT paid as part of leasing payments. The possibility of being reimbursed VAT depended on the possibility of expensing the payments (which was not considered to be the same as depreciation). The Tax Code removed this dependency and established a fairly clear mechanism for reimbursing VAT (the use of tax offsets).

**Property Tax**

Tax on property that is a leased asset is paid by the party on whose balance sheet the leased asset is included. The rate for property tax is set by the legislative authorities of the Russian region in question and may not exceed 2% of the average yearly residual value of the property, established based on accounting records.

If the leased asset is recorded on the lessee’s balance sheet, the amount of property tax paid is higher than when the asset is included on the lessor’s balance sheet, as in this case the balance sheet value of the leased asset is equal to the value of the leasing deal. This is one of the reasons why many leasing companies prefer to record assets on their own balance sheet.

**Road Tax**

The taxable base for road tax is revenue from the sale of products (work, services). For leasing companies, revenue is the leasing payments in full.

The tax rate for the road tax is set at 1%. This tax will be abolished from January 1, 2003.9

The road tax is one of the few remaining turnover taxes, which were particularly burdensome for leasing companies. Until 2001, the total rate for revenue tax amounted to 4%. The reduction (and soon, removal) of turnover taxes represents a considerable improvement for the leasing environment.

Sales Tax

Until 2002, leasing companies had to pay sales tax if the lessee was an individual entrepreneur and the leasing payments were made by transferring funds from that individual’s bank account. From January 1, 2002, this situation changed with the enactment of Chapter 27 of the Tax Code chapter on “Sales Tax,” and payments from the settlement account of the taxpayer were excluded from the payments that fell under the heading of cash payments. Leasing payments made in cash are generally subject to sales tax. Sales tax rates vary by region.

Taxation of small companies

Until January 2002, small businesses had the right to apply accelerated amortization to production funds (with a ratio of up to 2) and, in addition, could write off up to 50% of the initial cost of the fixed assets in amortization.  

This regulation was not reflected in Chapter 25 of the Tax Code. However, we should keep in mind the provisions of Point 1 of Article 9 of the law “On State Support for Small Business,” according to which if changes in tax legislation create less favorable conditions than those in place previously, then within the first four years of activity of a small business, taxation is carried out using the same mechanism that was in place at the moment of state registration.

At the moment there are different points of view regarding the lawfulness of this regulation. For example, the Russian Finance Ministry has repeatedly expressed the opinion that it is impossible to apply the provisions of this law from 2002.

It should be noted that the parties to a leasing agreement could not ”double up” the accelerated depreciation for small businesses and for leased assets.

Upcoming changes in the taxation of small businesses

Federal Law No. 104-FZ “On amendments and addenda to the second part of the Tax Code of the Russian Federation and other legislative acts, and also on the abolition of various Russian legislative acts on taxes and charges,” was passed on July 24, 2002. This law added Chapter 26 (2) “Simplified taxation system,” and Chapter 26 (3) “System of taxation in the form of a single tax on imputed income from various types of activity,” which will come into force from January 1, 2003.

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The majority of small businesses may make use of the simplified taxation system, or change over to paying a single tax on imputed income.

**Simplified taxation system**

The application of the simplified taxation system by companies (individual entrepreneurs) involves replacing the payment of profit tax (revenue tax), VAT, sales tax, corporate property tax and the single social tax with a single tax calculated based on the results of a company’s business activity in a taxation period.

Companies with sales revenue over a nine-month period not exceeding 11 million rubles (not including VAT and sales tax) may use the simplified taxation system.

However, there are a number of provisions that restrict the application of the simplified taxation system. For example, companies with direct ownership by other companies of over 25%, or with over 100 employees, or with depreciable property of over 100 million rubles do not have the right to apply the simplified taxation system.

Since under leasing the ownership of the leased asset is retained by the leasing company, a lessee may acquire equipment exceeding 100 million rubles and retain the right to use the simplified taxation system. Sales revenues may still not exceed a limit of 15 million rubles per annum, however, and in practice few leased assets valued at over 100 million rubles would not require at least 15 million rubles of lease servicing.

A taxpayer may choose the base to the taxed, revenue or gross revenue minus gross spending. Depending on the taxable base chosen, the tax rate will be 6% or 15% respectively. In addition, rental (leasing) payment will be permitted as an expenditure.

We should note that in establishing the taxable base, the taxpayer also deducts from revenue spending on the acquisition of fixed assets. In addition, for fixed assets acquired during the period the simplified taxation system is being applied, the cost in full is included in spending at the moment these assets are installed. As regards assets acquired by the taxpayer prior to the transfer to a simplified taxation system, the cost of the fixed assets is included in spending during a period of time established based on the useful lifespan of this equipment.

The possibility of applying the cost of the property acquired to spending at the moment this spending is carried out will obviously reduce the relative attractiveness of leasing for those companies applying the simplified taxation system. Leasing expenditure, in the form of leasing payments, will reduce the taxable base during the period of the leasing agreement, while with the direct purchase of fixed assets the taxable base is reduced immediately. We should note that earlier, according to Russian Federal Law No. 222-FZ from December 29, 1995 “On a simplified system of taxation, accounting and reporting for small businesses,” a strict list was established for expenditure that may be applied when calculating the taxable base, when the composite revenue indicator was used as the basis for tax assessment. In addition, neither spending on the acquisition of tangible as-
sets nor leasing payments for property received under a leasing agreement were included as expenditure.

We expect this change may reduce the demand for leasing somewhat, although the size of the change is difficult to predict. First, many small businesses will still require outside financing, and leasing may be appropriate for other reasons. Second, the upper limit for revenues is not very high, although the effect will depend on the type of business. Finally, deducting the full value of an asset against profits may not be appropriate for many businesses that do not have sufficient profit to write off expensive equipment all at once (and there are limitations on carrying losses forward for profit reduction); while there will be other means to manage declared profits, leasing may also be an appropriate instrument.

**Single imputed income tax**

A system of taxation in the form of a single imputed income tax for various types of activity may be applied based on a decision by a Russian region, for example, in the event of the provision of household services; veterinary services; services to repair, service and wash transport vehicles; and freight and passenger transport services when not more than 20 vehicles are used.

The payment by organizations (individual entrepreneurs) of a single tax on imputed income involves the replacement of profit tax (on personal income), VAT, sales tax, property tax and the single social tax.

The tax base for the payment of the imputed income tax is understood as the amount of imputed revenue, calculated as the product of base revenue from a certain type of entrepreneurial activity and the size of the physical indicator characterizing this type of activity, which are established in article 346 (29) of the Tax Code of the Russian Federation. In addition, base revenue is corrected by coefficients depending on the land register value of land at the location where the entrepreneurial activity is being carried out.

The single imputed income tax rate is 15%.

As the base for taxation in the event of the application of the single imputed income tax is the total size of company revenue, without the possibility of deducting expenditure, including leasing payments, leasing loses its advantage of saving on profit tax.

**Conclusion**

We are sure that the passing of the Tax Code of the Russian Federation is a significant step in the development of the leasing sector, as the main aspects of the tax regime that are favorable for leasing, have been retained. In particular, retaining accelerated amortization and the possibility of choosing the side that will include the equipment on its balance sheet are possibly the most important aspects. A reduction in the profit tax rate should have a positive influence on the activity of all companies, including potential lessees, and should therefore only be welcomed.
The codification of these advantages in the Tax Code of the Russian Federation significantly reduces the uncertainty that existed earlier due to a number of contradictions in various regulatory-legal acts.

**ACCOUNTING**

The main document regulating the accounting system for leasing operations is Finance Ministry Decree No. 15 of February 17, 1997, “On Reflecting Leasing Operations in Accounts.” In practical terms, other regulatory acts are also relevant, such as the Plan of Accounts for Accounting for the Financial-Economic Activity of Companies, and the Instruction for its application (confirmed by Decree No. 94 from the Finance Ministry of October 31, 2000), the regulations for accounting for revenue, costs, accounting for fixed assets and other regulatory documents.

**Recording property on the balance sheet of the lessor**

If the property is included on the balance sheet of the lessor, the following accounting system is used:

**Lessor:**

The property is recorded in account 03 “Revenue investments in material valuables,” at acquisition cost, including delivery and installation and expenses on bringing the property into a condition suitable for use.

- Amortization is calculated and expensed.
- Leasing payments received are accounted for as sales revenue.
- Property tax is accounted for and paid.

**Lessee:**

- Leased property is included in an off-balance sheet account.
- Leasing payments are expensed in full.

**Including property on the balance sheet of the lessee**

If property is included on the balance sheet of the lessee, the following accounting system is used:
Lessor

- Property is included in the off-balance sheet account 021 “Fixed assets, rented out.”
- During the period of the leasing deal, leasing payments are recorded as accounts receivable from the start of the leasing period.
- The difference between the total amount of leasing payments and the cost of the leased property is reflected as revenue in future periods.
- Accounts receivable are reduced as leasing payments are received.
- The difference, reflected as revenue in future periods, is recorded in the Sales account in proportion to the payments received. Consequently, the account for revenue of future periods is reduced over the life of the lease agreement.

Lessee:

The leased property is recorded as fixed assets at a cost equal to the sum of all leasing payments. ¹¹

- The sum of lease payments due are recorded as accounts payable.
- Amortization is calculated and expensed. ¹²
- Accounts payable are reduced as leasing payments are paid over the term of the lease.
- Property tax is accounted for and paid.

We should also note that when property is recorded on the balance sheet of the lessee, some circumstances may arise which require additional explanation. In particular, to date regulations have not been established for accounting for the completion of leasing payments, including early completion and a number of other issues.

To clarify the activities of organizations in similar situations and to avoid the imposition of fines, we recommend the parties to a leasing deal request an explanation from the tax authorities or other corresponding government departments regarding which regulations for bookkeeping and tax accounting should be applied. Regional application of these procedures can vary, as some regions have less experience with leasing.

**Depreciation for accounting purposes**

For accounting (as opposed to taxation) purposes, the regulations for the amortization of fixed assets are established in accordance with Section III of the Accounting Statute “Accounting of Fixed Assets,” PBU 6/01, confirmed by Russian Finance Ministry Decree No. 26n from March 30, 2001.

¹¹ In order to calculate profit tax, the lessee records the asset at the sum of all the leasing payments for its acquisition, supply and installation until suitable for use.

¹² Unlike bookkeeping, in order to calculate profit tax, the lessee includes amortization and the difference between leasing payments and amortization as expenditure.
In accordance with Point 18 of this accounting statute, depreciation of fixed assets is carried out using one of the following methods:

1. **The straight-line method.**
   With this method the annual depreciation value is established based on the initial value (including re-valuations carried out) of the fixed asset and depreciation calculated based on the period of useful operation of this item.

2. **The declining-balance method**
   When using the declining balance method, the depreciation expenses are calculated based on the residual value of the fixed assets at the start of the reporting year.

3. **The sum-of-all-digits method**
   The annual norm of amortization is established based on the initial cost (including re-valuations carried out) of the fixed asset and the following ratio: number of years remaining until the end of useful operation over sum-total number of years of the useful life of the object. (For example, if the useful life of the asset is three years, the denominator would be six: 1+2+3 years).

4. **The production (or activity) method**
   Depreciation is based on the volume of production (work) in the reporting period in relation to the initial cost of the fixed asset and the proposed volume of products (work) for the entire period of useful operation of the fixed asset.

Within the reporting year, depreciation of the fixed asset is carried out monthly regardless of the method used, in the amount of 1/12 of the annual amount. This means that regardless of the depreciation method chosen, throughout the year equal sums will be depreciated each month.

It should be noted that according to the Accounting Statute 6/10, the useful life of the asset may be established based on legal and regulatory and other restrictions on use of the asset, for example the rental period (Point 20 of Statute 6/01). In other words, the lessor or the lessee, depending upon which balance sheet the property is recorded on, may for accounting purposes fully depreciate the cost of the leased asset against expenses over the term of the leasing agreement.

For the purposes of tax accounting, amortization is established based on the period of useful operation of the leased asset in accordance with the Classification of fixed assets and the acceleration ratio chosen.

**Accounting for interest expense**

The regulations for accounting for interest expense are established in the Accounting Statute “Accounting of loans and credits and spending on their servicing.” (Accounting Statute 15/01), confirmed by Finance Ministry Decree No. 60n from August 2, 2001.
According to Point 12 of this statute, interest expenses are considered expenditures for the period in which these payments are made, with the exception of the principle.

According to Point 11 of the Accounting Statute 10/99 “Company Expenditures,” and also point 14 of Accounting Statute 15/01, interest paid by an organization for borrowed funds and expenditures connected with the payment of services provided by credit organizations, are considered to be operational expenses.

If funds are borrowed for a capital investment, then interest should be included in the cost of this asset and is depreciated, i.e. interest on these borrowed funds paid prior to the inclusion of the fixed asset in accounts, is included in the initial cost of the fixed asset.