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LEASING TAX ADVANTAGES, HOW WELL DOES ALBANIAN LAW RECOGNIZE AND ENCOURAGE THE USE OF FINANCIAL LEASING AGREEMENT?

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Abstract

The tax advantage of financial leasing transaction embody one of the essential reason for business and privates often preferring leasing instead of a conventional loan for financing asset acquisition. It is not surprising that the volumes of financial leasing agreement has grown steadily over the last decades, and especially for the developing countries. Meanwhile we cannot say the same thing for Albania where although its potentials are high, its growing rate are very low. In this article we aim to analyze the Albanian legal framework, the practical aspects of this effective financial techniques, by simply answering the question: How well does Albanian law recognize and encourage the use of financial leasing both nationally and internationally? A special attention is devoted also to the fiscal treatment of financial leasing contract. This study analysis the current situation, and future trends and developments of the leasing market in Albania

Keywords: tax, financial leasing, contract, leasing market

1. Introduction

In private law leasing is one of the most controversial contracts, and has been subject to constantly study because of its complex nature and the various interpretations that exist on its classification. Determining the most appropriate classification of leasing has not only a theoretical and academic importance but mainly practical, and especially in international transactions. For this reason, before starting the analytical analysis of financial leasing, it would be helpful to initially provide an introductory definition in order to create an initial idea and to clarify the subject of all the following research.

The word "leasing"¹ originates from the verb in English "to lease" and symbolizes heterogeneous issues, characterized differently depending on the needs of economic operators, the context in which they are developed, the nature of the item and the modality of engagement.² This new

¹ "to lease.. means making an agreement under which it is paid to use a building, a land, a device for a certain period of time" - Macmillian English Dictionary for advanced learners, second edition, 2007, page 856.

² Mariassunta Imbrenda, Il leasing finanziario, Trilateralità funzionale ed equilibrio del rapporto, Studi monografici, Napoli, Edizioni Scientifiche italiane 2005, page 9

contract, "production" of the requirements of economic operators, is being used more and more in the global marketplace. There is no single general leasing legal scheme in the commercial practices of different countries, but a variety of models associated with the same term, accompanied by different adjectives that have the common denominator the financial profile (*financial leasing, private leasing, agricultural leasing, instrumental leasing etc.*)³ In its entirety, the term leasing is used to define a series of cases that compete to form the "funded user" phenomenon.⁴ Just as the other "novel contract " originated from the Anglo – Saxon commercial practices (factoring, franchising) leasing represent in a physiognomic plan a high margin of elasticity in order to protect the changing business sector interests that materialize in economic exchanges and commercial practices. The businesses, especially the small and medium ones, have the possibility, to ensure the financing sources for modern technological lines, machineries, vehicles or services from consolidated producers in the country and abroad, by becoming more competitive in the internal and foreign markets.

Leasing arrangements cover many types of asset such as movable items like motor vehicles, equipment, aeroplanes, etc and immovable goods etc

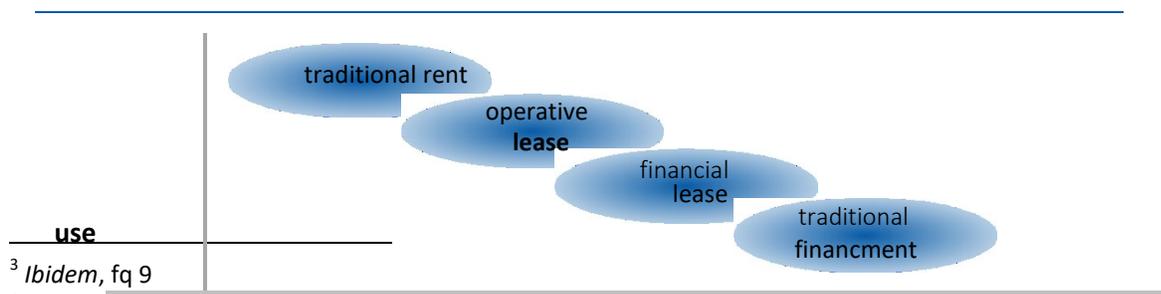
However in Albania, unlike the general trend in other countries, it is limited in a narrow segment, with an insignificant weight in the country economy, financing primarily vehicle purchases. So in Albania financial leasing did not turn into a massive financial instrument in meeting business and customer needs

2. Characteristics of the financial leasing contract in Albania.

In Albania, financial leasing agreement is regulated in detail with the law no. 9396, dated 12.05.2005 "On the financial lease", as amended by law no. 9823, dated 29.10.2007 and law no. 9966, dated 24.07.2008, according to which: "A **financial lease is an agreement whereby one party, the lessor, conveys the right to use an asset, in exchange for periodic payment and allows the legal ownership of the leased asset to be transferred from the lessor to the lessee on full payment of all of the lease payments.**" Bearing in mind the definitions made in international accounting standards (IAS 17) and the legislation of many countries, including fiscal provisions, financial leasing is differentiated from traditional hire and from operational leasing agreement. Moreover the financial lease has a specific purpose to finance the lessee, so it involve supply of finance.

Presented schematically in the figure below the financial leasing is positioned between operating leasing and traditional financing.

Figure 1⁵



³ *Ibidem*, fq 9

⁴ M. R. D' ADDEZIO, "Leasing in agricultura", Torino, 1992, page 488

⁵ Alessandro Carretta, Il leasing operativo, i quaderni di Assilea 13

Financial leasing transaction includes three parties -- the lessor, the lessee and the supplier, and two contracts - the supply contract and the lease contract. In commercial practices, financial leasing has followed a practically homogeneous practice, putting emphasis on the implementation of a set of actions necessary for its realization. To be defined as financial leasing, an agreement requires the presence and competition of the elements organized chronologically in the following phases:

- The first step in the operation is taken by the prospective lessee whom selects the supplier and the equipment according to its requirements,
- Once the equipment has been selected and the supplier chosen the lessee enters into a lease contract with the lessor requiring the acquisition of the equipment from the supplier and granting the use of it in the return for certain (periodic) payments. The rentals payable under the leasing agreement are calculated so as to take into account in particular the amortization of the whole or a substantial part of the cost of the equipment.
- the lessor thereafter enters into a supply contract with the supplier, acquiring the asset selected by the lessee, meanwhile the supplier must be aware that the equipment is being acquired in order to lease to the lessee
- the supplier delivers the equipment to the lessee.
- At the expiry of the period fixed in the leasing contract, the lessee has three option :
 - the lessee is entitled to seek renewal of the leasing contract for a further period, usually by continuing the contract with reduced rentals calculated on the basis of the equipment residual value at the end of the fixed period.
 - the lessee may conclude the contract and return the equipment to the lessor in a good working state or
 - the lessee may exercise the option to purchase the equipment leased with a symbolic price.

Typically in countries belonging to civil law family, including Albania the final purchase option constitutes an essential element of the financial leasing contract but is not so in other countries especially in those belonging to common law systems⁶

Some of the most important characteristic of leasing agreement in Albania are:

- The financial lease contract is a continuous execution contract, which means it continues to be a source of liability for the parties involved in the agreement throughout the term of the contract.
- According to the Albanian legislation, the parties expressly provide an initial term which varies depending on the nature of the leased object or its economic life and must in any case be within the minimum limits foreseen by the legislator.⁷ As can be seen usually immovable property is leased for a longer term than movable property. The duration of the lease contract

⁶ FRIGNANI, Leasing finanziario internazionale: analisi comparata, 2000. P.283

⁷ For example, for movable items with a consumption term up to five years is foreseen a minimum period of at least one year; for movable items with a consumption term of over five years, is foreseen a minimum period of at least two years is stipulated and a minimum period of three years for immovable items- Article 9, point 2, Law no. 9396, dated 12.05.2005 "On financial lease" updated with: Law No.9823, dated 29.10.2007 & Law No.9966, dated 24.7.2008 "

is extended from the day of receiving the item from the leaseholder to the full liquidation of its value.⁸ At the end of the term of the contract, if the object is able to meet the needs for which it is leased, the lessee has the right to choose to renew the contract for another period and in this case with a lower periodical fee than the initial one.

- As for the form of the lease contract, while the civil code does not foresees any mandatory legal form, the law on financial lease foreseen for probative effect the written form. Given that the financial lease contract mainly regulates the relations of commercial entities, the written form is more appropriate. Also, since the financial lease contract is an executive title regarding the repossession of the item it is understandable that it should be contained in a written act.

However, the law provides exceptions, so if the contract foreseen the conditions for extrajudicial reinstatement of the thing in the cases of termination of the contract before the deadline for the lessee's fault the contract must it be done by a notary act because otherwise it is null. So in this case the financial lease contract is a formal solemn contract.

- The financial leasing contract is a contract under compensation, where compensation is liquidated by the lessee periodically and must be fair and real. The compensation in this case includes: Periodic payments of lease paid by the lessee during the term of the contract. Each of the periodic payments includes the amortization value of the item, the interest on invested capital, the administrative costs, the attitude towards monetary inflation during the duration of the contract. In the case of entering into a contract for a second term, a discount will be obtained in favor of the lessee and lease payments will be lower than the initial ones. The purchase price that includes the pre-determined contract price if the lessee decides to buy the item at the conclusion of the term of the lease.
- A special feature of the financial lease contract is the fact that after the lessee accept the item all the risks associated with the item passes to him. The concept of risk includes any atmospheric, natural or social events that cause damage, loss of theft or premature loss of usability.⁹ Also in case of death, body injury or non-property damage arising from the item the lessor is not responsible neither as a lessor nor as owner, this is related to the fact that the lessee in the financial lease contract chooses the property in all its features, together with the supplier. As a general rule, the lessee is obliged to secure the object of leasing agreement for any damage he or she may be threatening in the future.
- The financial subleasing contract it is presented as an autonomous contract in relation to the financial lease contract, since the lessor is exempt from the sublease relationship. However, the lessor has the right to retake the item also directly from the sub-lessee in the case of non-fulfillment of the contractual obligations by the lessee or the sub-lessee.

⁸ J.Vasili, "Kontrata civile jotipike", 2009, page 24

⁹ Cass 17.5.91, n.5571, in NGCC,1992,33

3. VAT treatment of financial leases

Vat treatment of financial leases has always been a major problem not only in our country but even in EU.

The VAT Directive, in EU, does not provide any rules in respect of the VAT treatment of financial leasing agreements. However, there is a wide jurisprudence of CJEU that has contributed in this field. With in long period of time the CJEU had been treated all leases as supplies of services since, in its view, it was uncertain whether ownership would be finally transferred.¹⁰ However, we can also mention exceptions, for example the Eon Asset case.¹¹ According to CJEU in Eon Asset, if financial lease provides for the transfer of substantially all risks and rewards, incidental to ownership, to the lessee, it constitutes a supply of goods for VAT purposes.¹² However this case remains the only example of application of this provision to a leasing contract, so the CJEU 's standing in the future remains to be seen.¹³

In Albanian the financial lease is taxable activity for VAT purpose, regardless of the quality of taxable person carrying out this activity.¹⁴ According to Albanian legislation, the financial leasing agreement is a contract that is analyzed as a lease for the lessee, who is given a simple purchase option by paying an approved price that takes into account, at least in part, the price performed in the form of periodic payments.¹⁵

According to article 7 of the law¹⁶, the supply of goods (item) conducted by the supplier to the lessor under the supply contract is the supply of goods.¹⁷ Therefore the Supplier issues a tax invoice with VAT of 20% for the supply and VAT is calculated on the value of the goods. The lessor register the invoice issued by the supplier as VAT purchase in the purchase book and is

¹⁰ Igor Kochkodan, VAT treatment of financial leases in EU law, HARN60 Master Thesis Master's Programme in European and International Tax Law 2014/2015

¹¹ C-118/11 Eon Asset

¹² Igor Kochkodan, VAT treatment of financial leases in EU law, HARN60 Master Thesis Master's Programme in European and International Tax Law 2014/2015

¹³ Ibidem

¹⁴ Instruction. 6, Date 30. 01. 2015 "ON VAT IN THE REPUBLIC OF ALBANIA ", Law no.92 / 2014, dated 24.07.2014 "On the Value Added Tax in the Republic of Albania"

Leasing activities can be carried out by banks, non-bank financial institutions and independent companies. Entities that carry out banking or financial activities can perform financial leasing activity only if the right to engage in leasing business is included expressly in the license or in the respective permit. The minimum capital requirement for independent leasing companies is 20 milion lekë (about \$ 20 milion Americans), and they can not carry out any activity other than that of the financial lease. By comparison, the other countries in the region require a lower capital or no request at all. These capital requirements may be a barrier for the leasing market.

¹⁵ Instruction. 6, Date 30. 01. 2015 "ON VAT IN THE REPUBLIC OF ALBANIA ", Law no.92 / 2014, dated 24.07.2014 "On the Value Added Tax in the Republic of Albania"

¹⁶ Ibidem

¹⁷ According to Article 14(1) of the VAT Directive, "supply of goods" means the transfer of the right to dispose of tangible property as owner.

entitled to deduct the VAT. In accordance with the determined lease term, the lessor delivers the goods to the lessee and for each month it charges the financial lease payment.¹⁸

At the end of the term, if the lessee exercises the opportunity to purchase the goods, the lessor issues a final invoice for the additional value that he has to pay as defined in the contract.¹⁹

The supply of financial lease is a taxable supply for VAT - when the financial leasing object is a commodity, which if purchased or made available to the lessee in normal conditions would be taxable with VAT, not exempt.²⁰

4. Motives of choosing financial leasing contract: Its advantages

Financial leasing has indisputable advantages for the business sector, for consumers and for the economy in general.

- A huge advantage of the financial leasing in Albania, in comparison to the banking loan, is that financial leasing it's a contract that does not require pledges or collaterals and thus it enables businesses to save valuable reserves of cash
- Leasing companies have greater opportunities to enter into contractual relationships with banks, insurance companies or other financial institutions, with powerful manufacturers or suppliers of goods and services within and outside the country, creating trust and access in financial resources and in consolidated markets. This would be difficult to be done directly by businesses, and more so by the family customers.
- A major advantage stemming from the use of leasing is the increase in business formalities. Leasing contracts, payments through banks and generally the information available to leasing companies can be used by tax authorities to increase the effectiveness of tax collection and combat evasion.
- In most developing countries, including Albania financial leasing can be the perfect form of finance for medium or small business needs of fixed assets. This form of financing has attracted more and more new borrowers by expanding the existing markets and promoting the overall development of the economy.²¹
- Financial leasing provides an efficient and effective use of capital. Since the financial lease provides the items instead of money for their purchase, the lessee cannot use borrowed funds

¹⁸ The taxable value written on the VAT invoice is the amount of the periodic payment, each month with 20% VAT, except for interest. So the leasing company should distinguish the value of the principal from the interests and calculate the VAT only for the principal, without interest. In this respect another advantage of finance lease is that allows the splitting of VAT in periodic canons over the entire duration of the lease, without attributing it all at once at the time of transfer.

This is a positive progress compared to the previous instruction No. 3 dated 30.01.2006 "On Value Added Tax" which foreseen that the procedure for calculating and paying VAT is applied on the full value of the installment including interest, which was discriminatory for financing through leasing in relation to financing through credit.

¹⁹ Instruction. 6, Date 30. 01. 2015 "ON VAT IN THE REPUBLIC OF ALBANIA"

²⁰ Instruction. 6, Date 30. 01. 2015 "ON VAT IN THE REPUBLIC OF ALBANIA ", Law no.92 / 2014, dated 24.07.2014 "On the Value Added Tax in the Republic of Albania"

²¹ Companies operating in the financial leasing market in 2016 increased their revenues by about 21%, while there is a decline in the number of operators reporting losses.

for other purposes. In some cases, to the lessee is offered the opportunities for lower equipment prices due to the high volume of sales.

- The lessor retains the ownership of the leased asset, which is usually used as collateral for the transaction, contributing to the simplification of the procedures. Being the legal owner of the asset, the leasing company is in a more secure position.
- Leasing procedures are quick and simple. As a result, the leasing company can accurately design cash flow during the term of the leasing contract, assuming the lessee will repay periodic installments in time.
- Leasing usually provides mid-to-long-term financing through a fixed fee during the term of the lease. The lessee can then easily determine the margins between financing and transaction costs in the lease contract.
- Technological Needs - Technology advances rapidly and in the space of a few years, businesses can find themselves with outdated devices that have no redistributive value. Leasing provides the opportunity to use new equipment through their regular updates to stay at the top of the technology curve.

But on the other hand, in Albania leasing as a financing source has a disadvantage because it requires that the value of the asset financed through leasing, should be prepaid at nearly 20 - 30%²²

5. Leasing market in Albania

Financial leasing in Albania, has remained a very narrow segment, with an inconsiderable weight in the country economy financing, by financing mainly the purchase of vehicles , and it is not being developed in the direction of the business needs for equipment's and new technologies, investments necessary for the grow of small and medium businesses. However it is a known that the greatest demands for tools come when large projects are initiated by the government or large private operators. A more positive dynamics in the public and private investment sector, will bring an increase of this item.

As noted in the tables above, the leasing market fell by 17.8% in 2015, however, in 2016 there is an increase trend. This market continues to be dominated by funding for personal transportation vehicles and work means of transport.

²² A . Korbi, Ll. Lleshaj, The financial leasing in albania and its financing costs, 371

Table 1 Institution that offer financing through leasing in Albania for 2016²³

Nr.	institution that offer financing through leasing
1.	Tranzit
2.	Raiffeisen Leasing
3.	FIN – AL
4.	Landeslease
5.	Porshe Leasing
6.	Albania Leasing
7.	Crimson Finance Fund Albania (CFFA)
8.	Tirana Factoring & Lease
9.	Albanian Financial Institution

The Table above shows the institution that offer financing through leasing. Nearly all the market in Albania is represented by 9 institutions. The companies operating in the financial leasing market in 2016 increased their revenues by about 21%, while there is a decline in the number of operators reporting losses.²⁴ Market operators estimate that there is a positive performance even in 2017, but the challenge remains consumer education, the development of the secondary market and the supply of products as close to the demand of certain segments in the economy.

6. Conclusion

Broadly the financial lease is possible to be define as a contract that conveys the right to use an asset and the right to exclude other persons from using it, involving supply of finance (financial element), in exchange for periodic payments. In difference with the simple hire or operated lease this type of contract is usually concluded when the parties have initial intention to transfer a right to dispose of asset as owner. Financial lease, in essence, presents acquisition of goods combined with supply of financing.

Basically, financial leasing is a legal relationship designed to respond to the needs of the three parties, namely: the lessee interest (*to use the equipment it needs*), the lessor interest (*benefiting*

²³ Referring to the Supervision Annual Report of the Bank of Albania, 2016

²⁴ Referring to the Supervision Annual Report of the Bank of Albania, 2016

from an economic interest from financing of the purchase) and the supplier (who benefits from the sale of the thing).

A finance leasing transaction would usually have the following characteristics.

1. The term of the finance lease is equivalent to the most useful part of the life of the asset.
2. The rentals are calculated to cover the capital outlay and provide a margin of profit.
3. The lessee's obligation to pay the rentals is irrevocable.
4. In the end of the agreement the lessee can purchase the item.

The financial lease activity is taxable for VAT purpose, regardless of the quality of the taxable person carrying out this activity. The supply of financial lease is a taxable supply for VAT - when the financial leasing object is a commodity, which if purchased or made available to the lessee in normal conditions would be taxable with VAT, not exempt.

Nowadays, due to the current market constraints, financial leasing can be a very good option for all the commercial companies especially for small and medium business.

In both the theoretical and practical Albanian environment, the treatment of the financial leasing contract has not found the right place because there are only a few cases of judicial practice, which can enable the consolidation of the position of this contract in the Albanian juridical theory. This underdevelopment of the leasing agreement was influenced by a number of factors, such as the legal infrastructure, the banking system, the level of education of business and family customers, and especially the development of the secondary market and the supply of products as close to the demand of certain segments in the economy. Also, since the greatest demands for tools come when large projects are initiated by the government or large private operators, a more positive dynamics in the public and private investment sector, will bring an increase of this item.

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