

# TYPES AND MECHANISM OF INTERNATIONAL LEASING TRANSACTIONS

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**Abstract:** *in today's market place there are lots of sources of firm financing exist. However, most companies try to find more profitable way to finance its international projects. Here lease could be the one of the most cost-effective form to finance this type of activity as well as to be the permanent source of funding for the company. In this article are analyzed lease as the source of financing, types of international leasing transactions, described the most popular mechanisms of international lease transactions.*

**Keywords:** *leasing, international leasing, leasing transactions, lease mechanism, lessor, lessee, lease agreement, sources of firm financing.*

## ТИПЫ И МЕХАНИЗМ МЕЖДУНАРОДНЫХ ЛИЗИНГОВЫХ ТРАНЗАКЦИЙ

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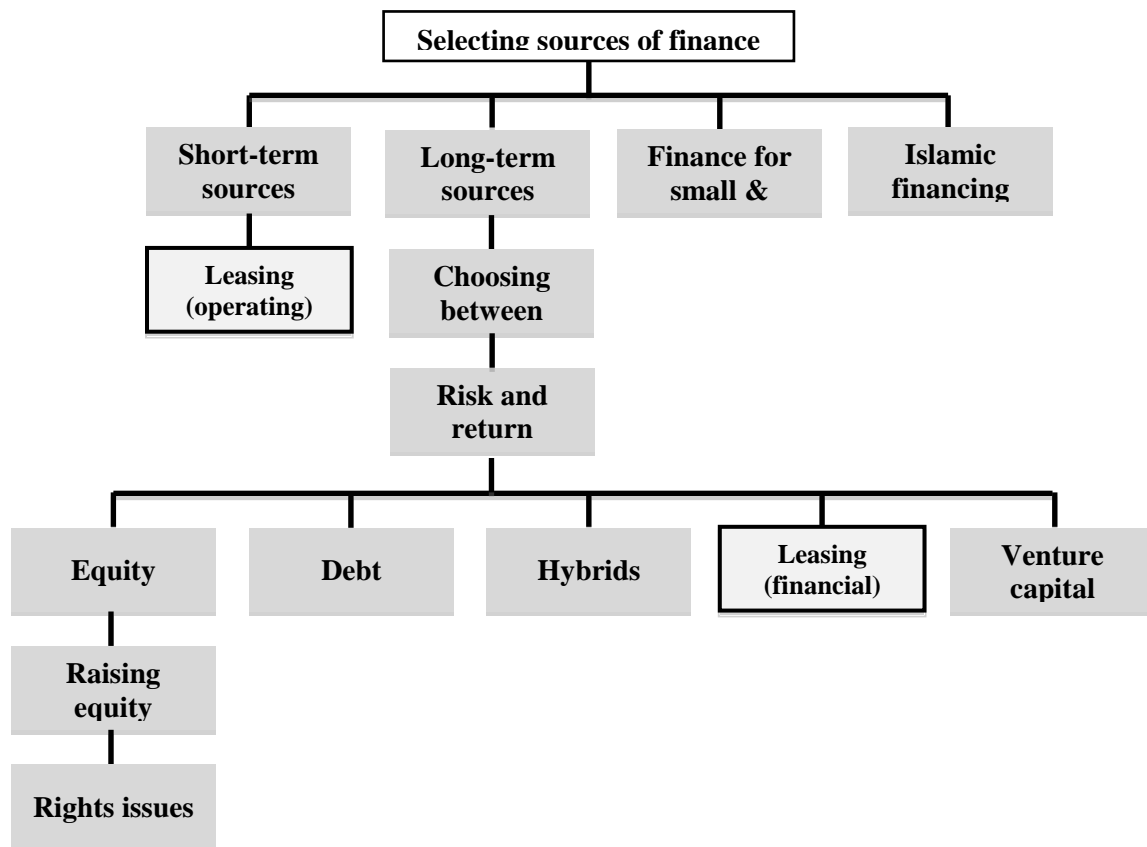
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**Аннотация:** *в современных рыночных условиях существует множество источников финансирования. Однако большинство компаний старается найти наиболее прибыльный для их международных проектов. В данном случае лизинг может стать одним из самых экономных способов финансирования, как международных проектов, так и деятельности организации в целом. В данной статье анализируются лизинг как источник финансирования, типы международных лизинговых сделок; описаны наиболее популярные механизмы осуществления международных лизинговых транзакций.*

**Ключевые слова:** *лизинг, международный лизинг, лизинговые транзакции, лизинговый механизм, лизингодатель, лизингополучатель, договор лизинга, источники финансирования фирмы.*

Nowadays more and more companies worldwide try to find the effective source of financing in order to become more competitive and profitable across different countries and regions.

In today's market place there are lots of forms of firm financing exist: corporate lending, venture capital, leveraged buy-out, securitization, whereas many companies prefer to use one of the most financially effective form of financing – leasing. Generally, all sources of financing could be structured in this way (see the Figure 1).



*Fig. 1. Sources of firm financing*

Thus, from the Figure above we could conclude, that leasing as well as other sources of financing could be used by the companies as an alternative way of business financing. In practice, especially for investment projects the most profitable financial instrument could be leasing. What is more, Richard A. Brealey, Stewart C. Myers and Franklin Allen consider that financial lease is an effective source of financing. If you sign a financial lease contract, you like borrow money. There should be an immediate cash inflow because the lessee is relieved of having to pay for the asset. Nevertheless, the lessee also will have an obligation to make the payments, which specified in the lease contract. The user could have borrowed the full purchase price of the asset by accepting a binding obligation to make interest and principal payments to the lender. In this case we could come to the conclusion, that the cash-flow consequences of leasing and borrowing are similar. In either case, company obtains cash now and pays it back later [1].

Significant contribution to investigating of leasing transactions effectiveness also was done by Baptiste A., Blank I.A., Gazman V.D., Gill E., Grabar N.A., Dill D., Jenson K., Dyurik E., Kadushkin A. Kamenev I.P., Kasimov A.V., Kiselev I.B., Cotter R., Lavery E., Lukasiewicz I., Myers S., V. Maslennikov, N. Mikhailov, Reid E., Smith R., Shtavrin V.A. and others.

According to Russian legislation, leasing – a set of economic and legal relations arising because of implementation of a leasing agreement, including the acquisition of the leased asset; lease agreement - a contract under which the lessor undertakes to acquire property specified by the lessee from a particular seller and after that give lessee the property for payment for temporary possession and use. The leasing agreement may provide that the choice of the seller and the property to be acquired by the lessor [2].

So, there are some main features of this type of agreement exist. Firstly, there must be 3 parts – lessee, lessor and particular vendor in this leasing agreement (lessee (user) to pay the lessor (owner) for use of an asset). Secondly, leasing agreement has to be based on two or more agreements – agreement of sell and buy and leasing agreement at least. Nevertheless, often the transaction is accompanied by the contract of property insurance, maintenance and others. Third, there should be acquisition of property specifically for lease.

Moreover, there is also very important document, which sets out the principles for the recognition, measurement, presentation and disclosure of leases - International Financial Reporting Standard 16 Leases (IFRS 16). This standard contains definition of lease agreement: lease agreement is a contract between two parties, the lessor and the lessee. The lessor is the legal owner of the asset; the lessee obtains the right to use the asset in return for rental payments. This standard also determines the relationships between lease subjects, types of leasing transactions and other points of lease. Thus, in the further Charters of this work we also will use this standard.

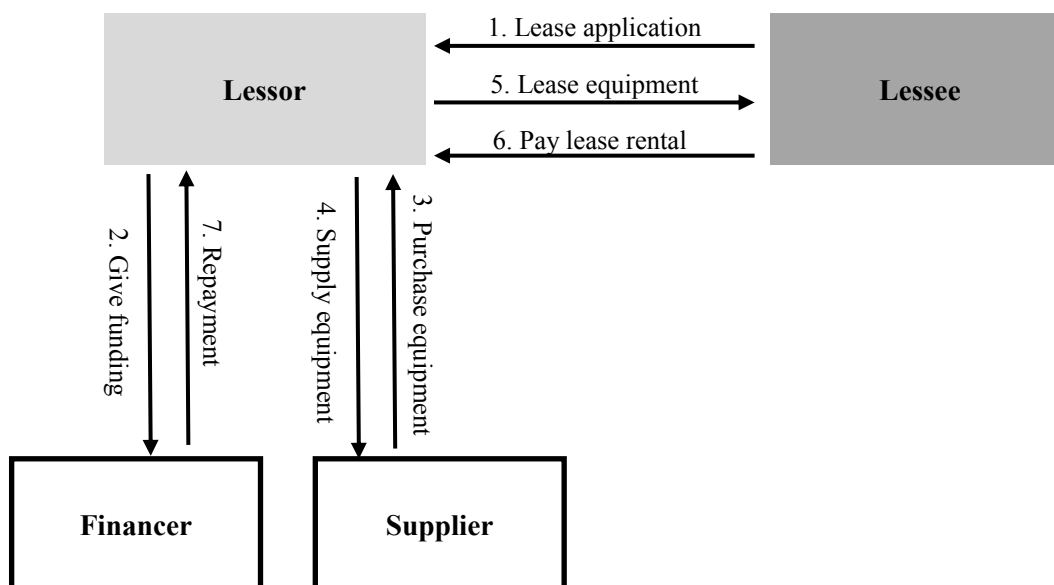
Generally, there are two types of leasing depend on parties' location and the place where lease agreement was signed: domestic and international leasing. Domestic lease takes place when all the parties to the lease agreement: lessor, lessee and the equipment supplier are domiciled or belong to the same country.

Vice versa we could say about international lease, which refers to the type of lease agreement where one or more parties to the lease agreement reside or are domiciled in different countries. What is more, international leasing also could be divided into import lease and cross border lease.

For the first type, both the lessor and the lessee belong to the same country, but the equipment supplier stays in some other country. Whereas if we are talking about the second type of lease- both the lessor and the lessee stay in different countries, irrespective of where the equipment supplier stays.

The difference between the domestic lease and international lease is the latter is exposed to two types of risks: currency (the risk involved in the fluctuations in the exchange rate as the payments tend to be denominated in different currencies) and country risk (refers to the tax and the regulatory framework prevalent in the country concerned).

Quite important to understand, that where are lots of types of leasing transactions worldwide exist, depend on kind of transaction and location of lease agreement parties. Nevertheless, there is a common mechanism of lease transaction exists, which is acceptable both for two types of lease: international and domestic (Figure 2).



*Fig. 2. Common lease mechanism*

Thus, based on contractual arrangements, the lessee is allowed to use an asset, which is owned by the lessor, whereas the lessee pays specified periodic rentals. The lessor relies on the lessee's ability to generate sufficient cash flows to pay the lease rentals (rather than to rely on the lessee's other assets or track record/credit history). Leasing enables also borrowers with limited track record / credit histories and collateral to access the use of capital equipment, often even in cases where they would not qualify for traditional commercial bank lending. [3].

Considering more detailed classification of international leasing, there are three types of that: export, import and transit.

According to the business scheme of export leasing the foreign party is the party of lessee, and prepared for lease equipment and leaves the country under the terms of the export contract. In worldwide practice, implementation of export lease mechanism enables to countries to solve the problems of countries export increasing, the resident of which is lessor; contributed to the strengthening and development of export potential.

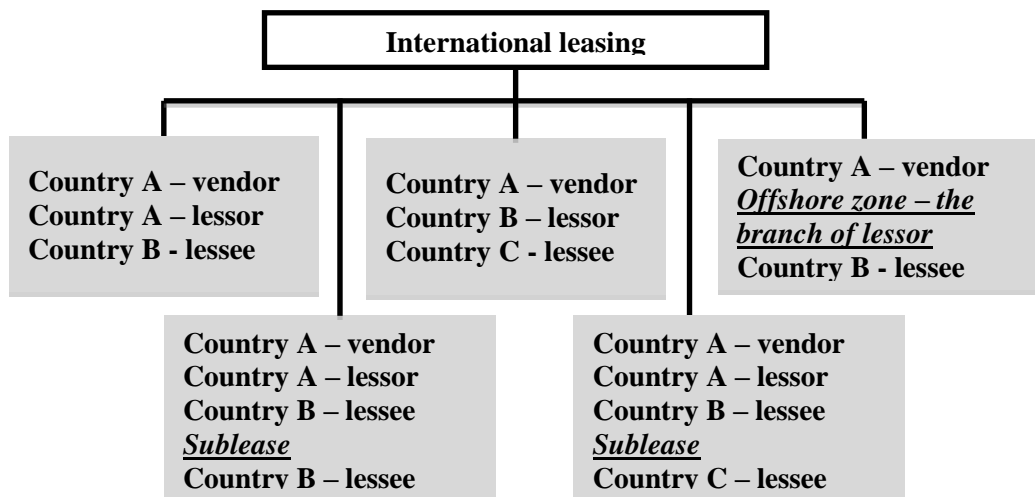


Fig. 3. Variety of international lease schemes

From the Figure 3 above we could see that there is variety of combinations take place in international practice of lease mechanism using. So, there is could be the situation, when residents of different countries could be the parts of lease transactions. Moreover, popular scheme of lease realization is the situation with offshore and sublease.

Generally, business schemes of export lease have some strong advantages over export sales, implemented in line with international trade contracts, and as a result, contributed to increasing of competitiveness of domestic products on international markets.

In the scheme of import leasing, the foreign part represents lessor and equipment is delivered to the country of lessee under the terms of import contract. Import leasing enables to use the necessary technological equipment, purchased by foreign lessor (leasing company, which is not the resident) from foreign manufacturers in order to transfer to the lessee under the lease agreement (to firm – resident). In Russia, the dealings of international import, as a rule, take place under the insurance of Russian government or other large structures (for instance, banks).

Considering the transit leasing, subjects of leasing – vendor, lessor and lessee- are the residents of different countries [4].

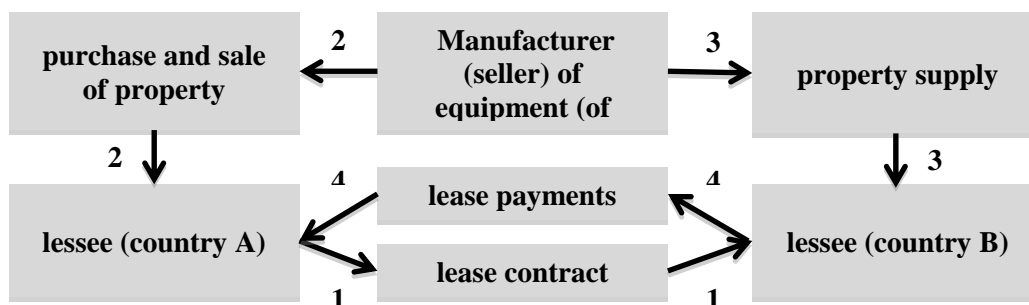


Fig. 4. Simplified scheme of transit international leasing

Transit international leasing take place in the cases, where lessor of one country takes a credit or purchase the equipment in other country and deliver this to lessee, which is located in third country.

As a rule, transit international leasing is controlled by transnational banks and corporations, which have subsidiaries - lease companies with an extensive network of international branches and representations, interacting with local lessees.

When investing in transit leasing compared to direct transactions, the lessor has a number of advantages: gaining access to local financial sources of lessee's country; reducing the risk associated with currency exchange; expanding the range of lease property; reduction of tax barriers to the transfer of the lease payments abroad; the lifting of restrictions on foreign partners - lessors; simplify property registration procedures of foreign owners name; the expansion of foreign markets for manufactured products.

The key point of subleasing, in practice of international leasing, is that leasing company – resident, getting the property from leasing company – non resident under the terms of scheme of international import leasing, transfer this property in line with lease contract (subleasing contract) to the final user. Effectiveness of these schemes exists due to possibility of combine tax benefits in two or more countries, particularly in countries, where different methods of determining of leasing property holder (in financial reports too) exist. There is an

experience, that some lease companies and offshore lease firms use the leasing schemes for producing the conditions of their investing programs realization. Nevertheless, the amount of such kind of dealings from year to year shrinking since governmental bodies try to prevent the possibility to obtain double tax benefits for companies.

The repayment of lease obligations could be done in the money form as well as in other form (product, for instance). In case of equipment lease compensatory lease could be used as a form of leasing. Here, the leasing payments could be done by goods, which were manufactured by lease equipment. In these cases involved a third party, which deals with the subsequent sale of these products.

The emergence of international leasing on the one hand increased the number of subjects of leasing schemes, their relationship, and eventually the whole complicated system of leasing relations, and on the other hand - has increased the number of international businesses and the boundaries of their functions, to the eventual complication of world economic relations.

International leasing contributes to the creation of conditions for development of innovative activity in the host country. With adequate use, the great potential of international leasing is innovative functions related to technology transfer, promotion of the diffusion of innovation, which provides the possibility of increasing the technological level by allowing developing companies to use modern technology, obtaining necessary equipment leasing.

Specific functions of the international leasing and some of its features led to the dynamic growth of international leasing operations. This is due to the following circumstances:

- Stimulating lease value in the system of world economic relations lies in the fact that its use contributes to an overall increase of competition on the financial capital markets
- An important feature of the international leasing in system of economic relations is its benefit to the country - the lessee: the sum of the debt for leasing is not included in the calculation of the national debt. Thus, it is possible to exceed the limits of accounts payable, which are established by the by the International Monetary Fund to individual countries.
- Scheme of international leasing allows attracting cheap funds from foreign financial institutions or funds of countries, interested in exporting their industrial products to other country.

In practice, using of international lease transactions linked to using of favorable tax regime, established in some countries. In particular, in different countries there are differences in the interpretation of the part - owner of the property - the leased asset for the purpose of taxation. And because the tax base is calculated without amortization charges on property, this situation can be used by both sides of the international leasing agreement and ultimately leads to the undeniable advantages of leasing compared to other financial products.

The methodology of lease scheme organization in the system of international business includes some factors, shaping its economic mechanism:

- contract currency;
- international responsibilities of government (UNIDROIT Convention);
- conditions of tax regime;
- the degree of property rights protection;
- features of legislation (also in taxation);
- the existence of conditions of agreements on non-use of double taxation between the two countries;
- the level of uncertainty due to exchange rate changes.

During the development of international lease mechanism is very important to determine the currency, which will be used for leasing payments and try to prevent inflation risks; outline all procedure of paying these payments and the process of obtaining income on the territory of other government. Thus, on the effectiveness of international lease scheme (in comparison with domestic lease) influence: choosing of contract currency; the risk of changing exchange rate; features of tax regime of lessee; features of lessor taxation; existing or absence of double taxation arrangements between countries – subjects of international lease; the degree of property rights protection; insurance of property and financial risks.

Finally, great potential of international leasing lies in its innovative features, which provide opportunities to strengthen the technological level of the real economy by reducing the risks with enabling enterprises to use advanced foreign technology. At the same time, the identification of financial leasing in the system of market relationships of world investment activity subjects allows to allocate leases in independent form, different from the traditional rental and credit.

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