



**International
Finance Corporation**
World Bank Group

39549

LEASING IN CENTRAL ASIA

A SNAPSHOT OF THE LEASING MARKET IN CENTRAL ASIA



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CONTENTS

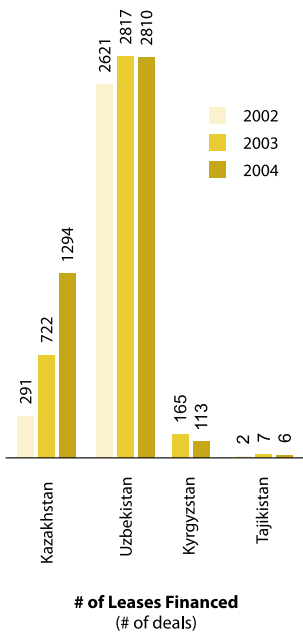
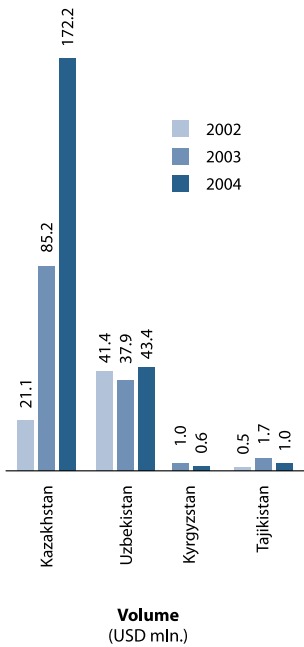
Introduction	3
Leasing in Central Asia: Synchronization of Leasing Policy throughout the Region	6
Leasing in Kazakhstan	9
Leasing in Kyrgyz Republic	15
Leasing in Tajikistan	19
Leasing in Uzbekistan	23
IFC's Central Asia Leasing Project	30
Our Sponsors	32

INTRODUCTION

Leasing is a medium-term financial instrument for the procurement of machinery, equipment, vehicles and/or properties. Leasing provides financing of fixed assets (equipment, vehicles, etc.) rather than direct capital. Leasing institutions - banks, leasing companies, insurance companies, equipment producers or suppliers, and non-bank financial institutions - purchase the equipment and then provide the equipment for a set period of time to businesses. During that period of time, the lessee makes periodic payments to the lessor which has the economic impact of charging an interest rate to the lessee. At the end of the period, the equipment is transferred to the ownership of the business or is totally depreciated and discarded or sold to a third party.

Leasing is based on the proposition that profits are earned through the use of assets, rather than from their ownership. Leasing institutions focus on the borrowers' ability to generate cash flow from business operations to service the lease payment, not on the balance sheet or on past credit history. This is why leasing is particularly advantageous for new, small and medium-sized businesses that do not have a lengthy credit history, nor a significant asset base for collateral.

The leasing market in Central Asia is poised for rapid development in 2005. Over the past three years, there have been several significant positive changes in the leasing market in Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan. The Parliaments in Kazakhstan and Uzbekistan have significantly amended their leasing legislations to make them more attractive for both foreign and domestic investment. Additionally, amendments were made to the Codes of Economic Litigation Procedures to create non-judicial repossession procedures. Also, Kazakhstan and Uzbekistan have both amended their respective tax codes to remove



barriers to leasing and create a level playing field with traditional bank credit. The leasing reform effort over the past three years has helped these two countries significantly strengthen their leasing markets, in particular due to the favorable tax climates which have created unique conditions for growth. The other two Central Asia countries - the Kyrgyz Republic and Tajikistan - have both adopted new laws on financial leasing that are equally progressive.

All of the recent changes have made the Central Asia region one of the most progressive for leasing in the world in terms of leasing legislation and tax policy. Leasing markets in Central Asia immediately reacted to the legislative and tax changes.

Kazakhstan has the largest volume of leases in the region by value (\$172.2 million worth of leases financed in 2004), which is a two fold growth over 2003. It is expected that volume of leasing will increase to over \$600 million by 2006 - 2007. Currently there are 20 lessors in Kazakhstan.

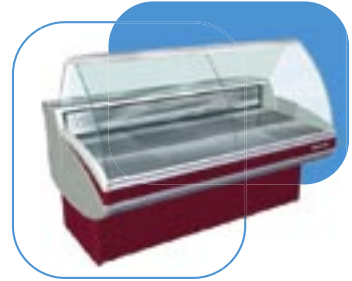
In Uzbekistan, leasing grew to more than \$40 million for small and medium-sized business in 2004. Even more indicative of the new leasing conditions, all of the major banks in Uzbekistan have entered the market and five new leasing companies have been established, so that there are now 28 lessors (banks and leasing companies) financing leases in Uzbekistan. The leasing market has also started to evolve in Kyrgyz Republic and Tajikistan, where further development of this market now depends on creation of a more favorable tax environment for leasing.

In Kyrgyz Republic, two major banks in the country are financing leases, and three microleasing companies are reaching the country's poorest regions. Additionally, the Financial Company to support credit unions has financed more than 180 leases. In Tajikistan, two banks have launched leasing products, and another two are developing new lease policies and procedures to start leasing operations.

Additionally, all four countries have recorded multi-million dollar cross-border leases from foreign manufacturers, banks, leasing companies, and other international lease providers.

These positive changes in the legislation were due to constructive partnerships among the Parliaments, Governments, local commercial banks and leasing companies, with support from international financial institutions, including the International Finance Corporation (IFC) which has set up technical assistance projects throughout Central Asia to assist in the creation and development of leasing. These partnerships formed the foundation for dynamic leasing growth in Central Asia.

Due to the market development, the International Finance Corporation has established an internal facility of \$30 million to finance lessors in Central Asia. The creation of this Facility confirms IFC's view that favorable conditions for leasing now exist in Central Asia. The Facility also includes a technical assistance component aimed at improving internal lessor operations. Practice shows that this is positive stimulus for foreign investors and will bring additional investment into the region.



LEASING IN CENTRAL ASIA: SYNCHRONIZATION OF LEASING POLICY THROUGHOUT THE REGION

Beginning in 2001 with the support of the seco - IFC Central Asia Leasing Project, the Central Asia countries have steadily improved their respective legal and tax frameworks. One result has been the unification of national legislations to support the development of regional investment in leasing. Amendments have been adopted to the Law on Leasing, Civil Code and Tax Code in Kazakhstan and Uzbekistan, and new laws on leasing and amendments to the Tax Code were adopted in Kyrgyz Republic and in Tajikistan. This work significantly unified the legislations and expanded access to lease finance for entrepreneurs and business across the region.

UNIFIED ELEMENTS OF THE LEASING LEGISLATION

1. Definition of Leasing

Unification of the definition of leasing throughout the region is based on the following principles:

- Mandatory participation of three parties to the lease: lessor, lessee, and supplier;
- Purchase of the leased asset specifically for transfer through a lease;
- The lease agreement must meet one of the several stated requirements (classifications), which are a combination of classifications for financial leases from IAS 17 and GAAP FAS 13; (classifications are not included in the Tajikistan Law on Leasing).
- Obligatory use of the leased asset for commercial purposes.

Additionally, Kazakhstan has established a minimum lease term of three years, and Uzbekistan of one year.

2. Civil regulation

- Leasing is defined as a type of “property hire” and thus, is governed by the overall principles of “property hire”. For example, the basis for early termination of a property hire agreement is also the basis for the early termination of a lease agreement;
- Leasing is defined as an investment activity based upon the purchase of a leased asset by a lessor using either debt and/or equity funds and the further transfer of the leased asset to a lessee on the basis of a lease agreement.

3. Legislative advantages for leasing that correspond through the region are:

- Non-bank financial institutions are not required to obtain a license to finance leases;
- Non-bank financial institutions are not restricted by obligatory capital requirements for leasing;
- There is no obligatory registration of the lease agreement; and,
- Leasing as an activity is not supervised by government structures unless the lease is financed by an institution already under supervision, such as a bank.



4. Accounting of leases

- The Kyrgyz Republic and Tajikistan have adopted International Financial Reporting Standards (IFRS);
- In Kazakhstan, banks and joint stock companies use IFRS, and other organizations are still applying National Kazakhstan Accounting Standards. Leasing is governed through National Standard “Leases”;
- In Uzbekistan, National Accounting Standards are applied; however, banks also prepare their annual financial reports according to IFRS.

Both the Uzbekistan and Kazakhtan National Accounting Standards for leasing are very similar to International Accounting Standard 17 “Leases”. For both accounting and taxation purposes, leased assets are accounted for on the balance sheet of the lessee in all four Central Asia countries.

5. Taxation and customs regulation of leasing operations

The Tax Codes of the Central Asia countries use classifications, included in the Laws on Leasing to define a lease. The only difference between the civil regulations and the taxation framework is that the tax codes only impact leases in which the asset leased is a fixed asset.

In each country, leasing is at least on the same taxation “playing field” as bank credit; and in some countries, leasing is a more effective instrument from a tax point of view. For example:

- In Kazakhstan, Kyrgyz Republic and Tajikistan, the interest portion of the lease payment is not levied VAT and VAT payable on the equipment purchase is offset;
- In Uzbekistan, VAT is not levied on lease payments;
- Equipment that is imported into Kazakhstan, Kyrgyz Republic, and Uzbekistan to lease is not levied VAT on import.



LEASING IN KAZAKHSTAN

AN OVERVIEW OF THE MARKET

Common trends

The Kazakhstan Government has prioritized fixed asset replacement in the manufacturing and service sectors to reduce the country's dependence on natural resources and build long-term economic sustainability. Currently, approximately 60% – 80% of all manufacturing equipment in Kazakhstan is in need of replacement to compete in the world market. One of the most effective mechanisms to finance this transfer of equipment is leasing, particularly for SMEs.

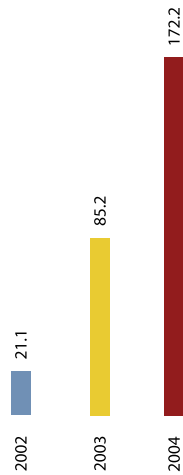
Amendments to the Law on Financial Leasing, Civil Code, Tax Code and Code of Litigation Procedures have created one of the most progressive civil and fiscal frameworks for leasing in the former USSR. Accounting of leases is the most approximated to IFRS.

Leasing started actively developing in 2000. At this time, KazAgroFinance, a 100% state-owned company created by the Government to develop the agricultural sector and resolve social problems in rural Kazakhstan, financed the majority of leases. The market changed dramatically with the introduction of bank-owned leasing companies starting in 2001. If in 2000, there were only five leasing companies, now there are twenty, fifteen of which actively operate in the market. As of 2004, eight companies are affiliated with local commercial banks, and held 46% of the total leasing

market. KazAgroFinance, a state owned agricultural leasing company, held 19% of the market.

Within the last two years, leasing has grown rapidly in Kazakhstan. In 2003, there was a four-fold growth in the volume and value of leases, whereas in 2004, 1300 leases were issued for a total value of \$172 million, which is a two-fold growth compared to the previous year.

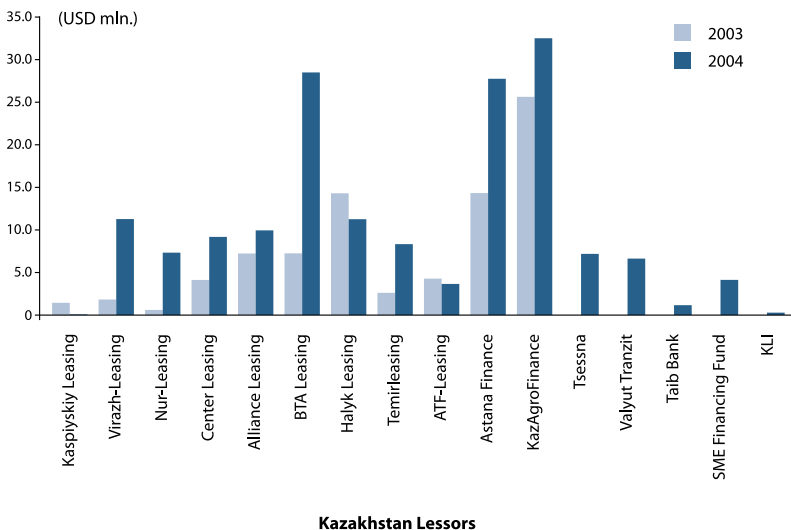
Leasing's share of the total capital investment in Kazakhstan was 1.5% in 2004, which is 5.7 times more than in 2002. The total lease portfolio of lessors increased, and as of the end of 2004 stands at \$220 million with 2600 leases. KazAgroFinance holds 28% of this volume.



Leasing Market Growth
(USD mln.)

Leased Assets

As the Government created the first leasing companies to finance agricultural equipment, agriculture still dominates the leasing market in Kazakhstan with 48% of the total lease value. KazAgroFinance financed 47% of agricultural leases, and Astana Finance 40%. The majority of agricultural leases are for tractors and combines, with combines making up to 80% of the market.



Kazakhstan Lessors

Lease Term and Lease Size

Most leases financed in Kazakhstan are for 3–4 years, except for leases financed by KazAgroFinance which are 6–7 years. The average lease size in 2004 was \$133,000, which is 13% higher than in 2003. The smallest lease in 2004 was for \$500, and the largest lease was for \$4 million.

Sources of Financing for Leasing

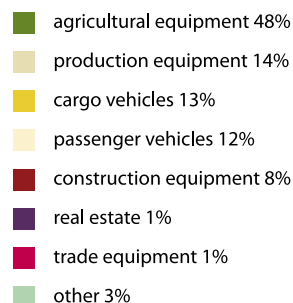
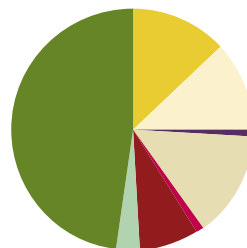
Commercial bank financing composed the bulk of lease financing, providing 85% of the financing needed by lessors to write leases. The remaining 15% of transactions were financed through lessors equity.

National bank prudential regulations restrict the total amount of financing that can be provided to affiliated subsidiary companies to 10% of bank equity capital.

In 2004, six leasing companies received more than \$60 million in foreign credits. With the growth of leasing, improved legislation, and the transition to International Accounting Standards in 2005, it is expected that more leasing companies will now be able to source financing from new domestic and foreign investors.

Leasing's Potential in Kazakhstan

Leasing companies have estimated that in the next 2 – 3 years volume of leasing will increase to over \$600 million which is approximately 5% in the total share of capital investments in the country. And as new leasing companies enter the market and existing companies source new financing, competition will increase, lowering interest rates and increasing lessor efficiency and quality of services.



Leased Assets, 2004

LEGAL FRAMEWORK FOR LEASING IN KAZAKHSTAN

The civil regulation of leasing in Kazakhstan is governed by the Civil Code, adopted in July 1999, and the Law on Financial Leasing of the Republic of Kazakhstan, adopted in July 2000. The Civil Code and the Law on Financial Leasing were amended and signed by the President into law on February 18, 2004. These amendments made Kazakhstan's Law on Financial Leasing extremely forward-thinking and will include model clauses such as the development of secondary leasing, subleasing, and leaseback arrangements.

Benefits of the Kazakhstan legislative framework for leasing include:

- A new definition of leasing that conforms with IAS lease classifications;
- A new definition for the term of leasing that protects lessors against tax losses if the equipment is repossessed in the first 36 months of the lease;
- The introduction of secondary leasing to ensure that lessors can lease equipment repossessed from a first client to a second client;
- A more precise definition of subleasing and leaseback arrangements;
- Clearer non-court repossession rights for the lessor;
- Clearer rights and responsibilities of the supplier, lessor, and lessee.

Also, banks in Kazakhstan have transferred their financial reporting to IFRS, and joint stock companies will make this transition in 2005.

TAX FRAMEWORK FOR LEASING IN KAZAKHSTAN

The Tax Code of Kazakhstan was enacted fully on July 1, 1999 and governs all taxation for leasing in Kazakhstan. While there have been regular changes to the tax conditions for leasing, taxation for leasing was significantly amended on December 1, 2003, coming into effect on January 1, 2004. Due to the new tax regime, leasing is growing rapidly in Kazakhstan. The tax advantages for leasing in Kazakhstan include:

- Lessors do not pay corporate income tax for all leases financed over 36 months;
- Lessors and lessees do not pay VAT on import for assets purchased for lease and imported into Kazakhstan (as approved through an extensive government list of equipment);

- Lessors and lessees have a simplified VAT payment structure for leaseback leases;
- Foreign lessors do not pay (lessees do not withhold) income tax on cross-border leases;
- Lessees are able to deduct the full interest portion of the lease payment from their taxable income and depreciation expenses;
- Lessees can take advantage of twice accelerated depreciation in the first year of equipment exploitation of the leased asset;
- Lessees can structure VAT payments throughout the duration of the lease;
- Lessees can take advantage of all of the tax advantages for corporate income tax and property tax offered under Kazakhstan's investment policies (in the Tax Code and the Law on Investment), as leasing is included in Kazakhstan's definition of an investment.



LESSORS IN KAZAKHSTAN

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BTA LEASING

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CENTER LEASING

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TSESSNA BANK

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JSC "FUND FOR DEVELOPMENT OF SMALL ENTERPRISES"

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LEASING IN KYRGYZ REPUBLIC

AN OVERVIEW OF THE MARKET

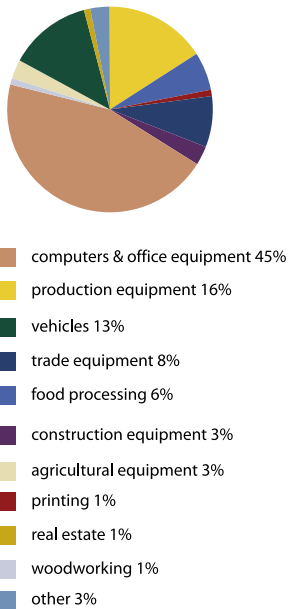
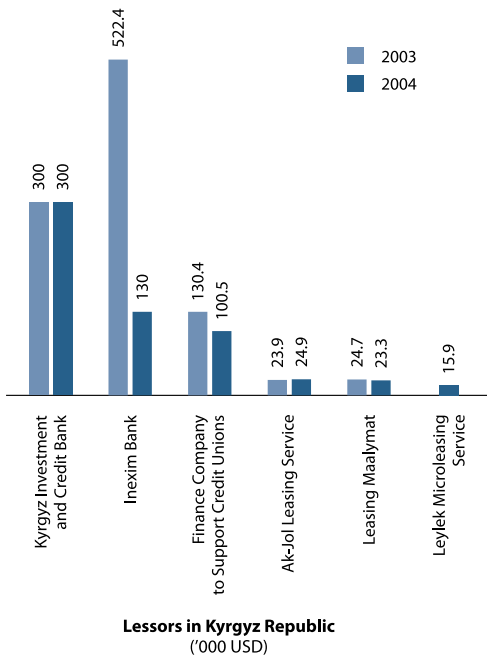
The Kyrgyz Republic has taken several steps to develop leasing as a financial instrument for small and medium-sized business. On July 23 2002, the President signed the Law on Financial Leasing.

In the Kyrgyz Republic, two major banks (Kyrgyz Investment and Credit Bank (KICB) and Ineximbank) are financing leases, and three microleasing companies are reaching the country's poorest regions. Additionally, the Financial Company to support credit unions has financed more than 180 leases.

Four banks (Demir Kyrgyz International Bank, JSCB Kyrgyzstan, Energobank, Tolubay Bank) and two financial institutions (Kyrgyz Agricultural Finance Corporation and Lease-Mortgage Company) have also announced leasing products.

Common trends

In 2003, the above mentioned institutions financed 113 leases for a total value of \$600,000. Lessors finance their operations primarily from their own funds. Three microleasing companies which started their leasing operations through grants received from European Commission Program to support SME in Kyrgyz Republic now provide leases from their own funds.



Leased Assets, 2004
(# of deals)

Leased assets

In 2004, the most common leased assets were office equipment (45%), production equipment (16%), transport (13%), trade (8%) and food processing equipment (6%).

Factors hindering growth of leasing in Kyrgyz Republic

Even though Kyrgyz Republic adopted progressive legislation to support the growth of leasing, several barriers have hindered growth. Most importantly, the demand for leasing has been stalled in Kyrgyz Republic due to the VAT issue.

Equipment imported under a lease agreement is not levied VAT on import; however, the further transfer of the asset from the lessor to the lessee once the equipment is in Kyrgyz Republic is levied VAT. If a bank provides a loan to a company and the company purchases equipment, it will be levied VAT when importing the equipment. The benefit of the Kyrgyz Republic system is that it allows the lessor to defer the VAT within the whole lease period. Given the fact most equipment is not produced and therefore imported into the country, the issue in the Kyrgyz Republic is that with leasing, it is hard to “cheat” at customs. In contrast, it is easy for companies to take out a loan and then to create fictitious documents when purchasing equipment and therefore pay less VAT. The main problem is that businesses prefer to import the equipment and under-invoice at customs to avoid VAT payment rather than lease the equipment and pay the full VAT even by installments during the lease period.

Currently, a new Tax Code is under development, and it is expected that when it takes effect in 2006, there will be a more favorable tax regime for leasing.

Perspectives

Solving the above mentioned problem will provide significant stimulus for leasing to develop in the Kyrgyz Republic. SME activity is growing rapidly and needs investment. The greatest demand is for equipment which costs less than \$70,000 in the following sectors: production, transport, services, food processing, trade, construction, woodworking equipment.

LEGAL FRAMEWORK FOR LEASING IN KYRGYZ REPUBLIC

Leasing is governed in Kyrgyz Republic on the basis of the second part of the Civil Code, adopted on January 5, 1998, and the Law on Financial Rent (Leasing), adopted on July 23, 2002.

The Civil Code defines leasing as a form of property hire (rent) and addresses overall concepts to govern leasing, such as the lease agreement, the leased asset, and the rights and obligations of the parties to the lease.

Leasing in Kyrgyz Republic is not licensed, though institutions that are licensed such as financial-credit institutions (banks and microfinance institutions) require additional noting in their bank licenses or certificates.

The Kyrgyz Republic has introduced third party commercial arbitration which can be used for repossession of leased assets due to breach of contract. Otherwise, repossession is conducted, if contested, through court proceedings.

TAX FRAMEWORK FOR LEASING IN KYRGYZ REPUBLIC

The Tax Code, in effect since June 1, 1996, is the major legislative act that governs taxation in Kyrgyz Republic. Taxation for leasing is based on criteria and classifications determined by IAS and impact VAT and profit taxes. Additionally, all finance leases must be at least 12 months in duration. The tax framework for leasing includes:

- VAT is levied solely on the cost of the leased asset, and not on the interest payment. Lessors have the right to offset VAT based on the amount stated in the invoice at the transfer of the asset to the lessee;
- Technical equipment (based upon a government approved list) imported into Kyrgyz Republic for lease is exempt from import VAT;
- Lessors' interest income from leases is taxed at 10% rate at the source of income (lessee).

LESSORS IN KYRGYZ REPUBLIC

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LEASING IN TAJIKISTAN

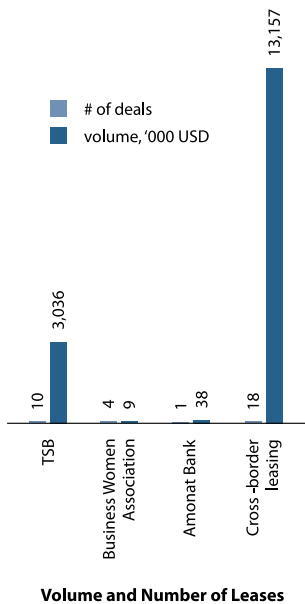
AN OVERVIEW OF THE MARKET

Leasing has been developing at a slow pace in Tajikistan. The growth is due to the move to create a fully adequate legal framework for leasing. In July 2004, a Government Resolution created a state working group to develop leasing in Tajikistan. The Program is supervised by the Ministry of Economy and Trade and has the following objectives:

1. Further development of the legal framework for leasing on the basis of the Law on Leasing and Leasing Accounting Instructions;
2. Reorientation of the country credit portfolio from the trade sector to industrial production through the creation of leasing companies;
3. Creation of a favorable tax environment for leasing.

Also, the National Bank of Tajikistan has taken steps to develop regulations for leases financed by credit institutions. And in the second half of 2005, the NBT plans to adopt Instructions on lease accounting for banks and other credit institutions.

As of the end of 2004 in Tajikistan, leases are financed by Tajiksodirotbank, Amonat Bank, and the Business Women's Association of Tajikistan. Also, one of the leading banks in the country "Agroinvestbank" has developed internal policies and procedures for leasing and plans to start financing leases to agricultural enterprises.



Tajikistan also witnessed the creation of the first leasing company – “Nahust – leasing”, which has Tajiksodirotbank as its main shareholder. This company plans to launch operations in 2005.

As in previous years, cross border operations surpassed domestic leases. In 2004, seven leases were financed for \$5.8 million. The leased assets in these transactions were telecommunications, pharmaceutical, agricultural processing, and textile equipment.

Nevertheless, the demand for leasing is far from satisfied. As was mentioned earlier, local lessors are willing to finance leases; however in most cases, the lease terms do not correspond to the recoupment period of the project, and interest rates are high. Therefore, most of the enterprises with access to external markets prefer to borrow from external creditors i.e. lessors (such lease terms are for 4 years on average, and interest rates do not exceed 14% per annum whereas rates of local lessors are vary from 22% to 30% per annum). This explains the cross border lease growth and also the reason for slower development in domestic leasing.

Perspectives

Manufacturers in Tajikistan are in dire need of new equipment to replace existing production lines. Aging equipment prevents companies from operating at full capacity, and therefore cannot meet demand. However, local businesses – both large and small, however, are unable to replace this equipment due to limited working and investment capital to purchase new equipment, and limited access to finance. Businesses turn to the Government, but it does not have the resources to support this investment.

Neither the manufacturing nor agricultural sectors can continue operating under existing conditions and are looking for new mechanisms and business processes. Leasing is one solution to this problem and could provide a necessary stimulus for growth.

Despite new lessors entering the market, there is still great demand for lease finance for industrial and agricultural enterprises. This is due to Tajikistan banks' lack of long-term resources.



LEGAL FRAMEWORK FOR LEASING IN TAJIKISTAN

Leasing in Tajikistan is governed on the basis of the Civil Code and the Law on Leasing, signed by the President on April 21, 2003. The Civil Code has instituted several norms that are special for leasing and supersede the general norms applied to rent relationships including repossession, risk relationships among the three parties, the lease agreement, and the transfer of the leased asset. The Law on Leasing builds on these definitions and provides more detailed roles and responsibilities for all three parties.

It is important to note that in contrast with the other Central Asia countries, this definition does not include obligatory classifications based on IFRS. As such for the purposes of civil regulations, leasing is not restricted by a lease term, the useful life of the leased asset, or the obligatory transfer of ownership to the lessee at the end of the lease agreement. However, this definition contains other obligatory aspects, such as participation of three parties (lessor, lessee, supplier) to the lease, the special acquisition by the lessor of the property for transfer through a lease, and the mandatory usage of the leased asset for commercial purposes. It is important to note that the legislation does not have a minimum lease period.

The Republic of Tajikistan acceded to the UNIDROIT Convention on International Financial Leasing on April 19, 2004. In cross border leases, the UNIDROIT Convention takes precedence over Tajikistan law and regulation. According to the UNIDROIT Convention, cross-border leases are operations in which a lessor and a lessee are located in differing countries.

TAX FRAMEWORK FOR LEASING IN TAJIKISTAN

The new Tajikistan Tax Code was enacted on January 1, 2005. In the new edition, leasing has a number of tax advantages including:

- VAT is levied solely on the cost of the leased asset, and not on the interest payment;
- Production equipment imported through cross-border leases is exempt from VAT on import;
- Interest paid as a part of lease payments to local lessors is not taxed at a source of income (lessee). It is included into the gross income of the lessor and taxed at 25% income tax after deductions;
- Interest income tax on cross-border leases to foreign lessors is withheld at the source of income at 12% rate;
- Lessees can apply up to two times accelerated depreciation on fixed assets set in operation after January 1, 2005.

LESSORS IN TAJIKISTAN

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NATIONAL ASSOCIATION OF BUSINESS WOMEN OF TAJIKISTAN

27, Hakim Karim Street, Khujand
Tel.: +992 (34 22) 6-31-27, 6-73-78
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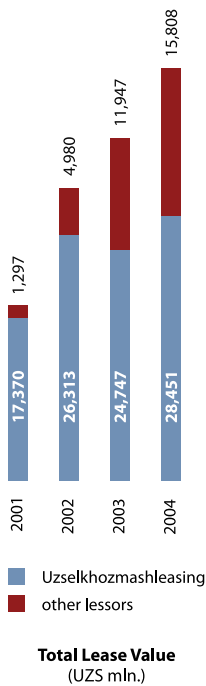
LEASING IN UZBEKISTAN

AN OVERVIEW OF THE MARKET

Until 2002, almost all leasing companies in Uzbekistan were established under separate Government Resolutions which granted individual tax preferences. The Presidential Decree No. 3122 “On Measures for the Future Development of Leasing” on August 28, 2002 created a strong basis for the sector’s growth. This Decree removed leasing’s greatest barrier by expanding all of the tax benefits available to credit to leasing. The Decree was then followed in 2002 - 2003 by over 40 legislative amendments to the Civil Code, Tax Code, Civil Litigations Code, and the Laws on Leasing and on Customs Tariffs. With this substantial overhaul, the legislative framework for leasing in Uzbekistan is now progressive and provides significant incentive for growth in the sector.

Further stimulus to leasing has recently been provided by Government Resolution issued in April, 2004, which provides lessees the ability to use accelerated depreciation for tax purposes to amortize the leased asset. This additional tax advantage for lessees will further assist small businesses acquire new equipment and technology for leasing. The Resolution also simplified procedures for registering and accounting for leased vehicles and reduced the fees levied to use notary writ to repossess leased assets.

Common trends

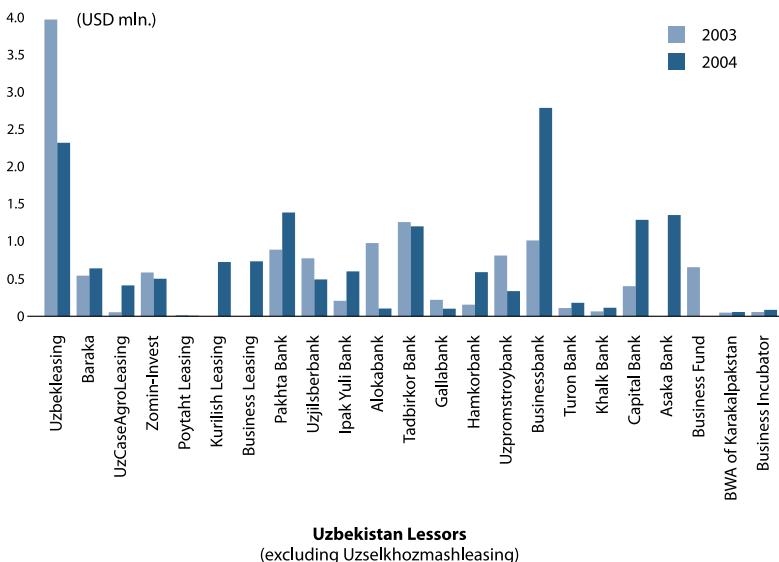


In 2003 cross-border leasing played a significant role in increasing leasing's share of total capital investment (\$53 million). When cross-border leases are included in leasing's percentage of capital investment, the percentage of leasing in investment is closer to developed countries (4.8%).

In 2004 the tendency of leasing volume growth remained. Domestic leasing grew by 21% in comparison with 2003 figures (17%).

Uzseldkhovmasleasing's (a state owned leasing company financed from a special Fund at the Ministry of Finance to stimulate replacement and improvement in agricultural equipment) market share is gradually declining, though still remains at a relatively high level. If in 2001, the share was 93% and 84% in 2002, by 2004, it had decreased to 64%.

This decline is due to the increase in bank lease operations as well as the creation of new leasing companies. In 2002, there were only 13 lessors; now there are 28. Fifteen of these are banks, eleven are leasing companies, and two are microfinance institutions.



IFC's 2005 Leasing Market Survey also shows that companies for which the primary activity is not leasing also started to finance leases.

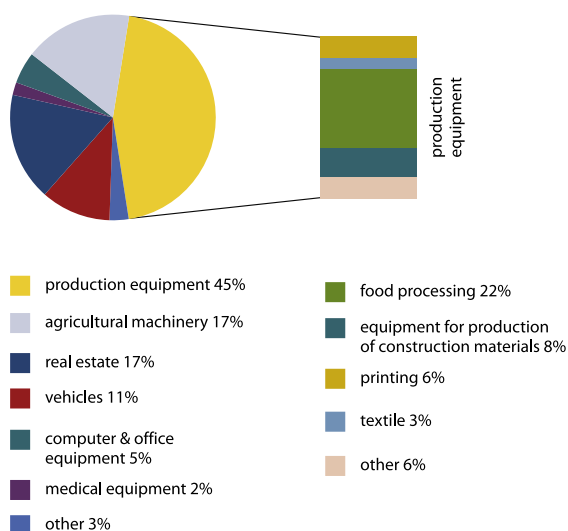
Overall, in 2004, 2810 leases were financed for a total volume of \$43.4 million (\$37.9 million in 2003). Commercial banks' share in this figures is \$10.2 million as compared to \$6.7 million in 2003.

Uzbekistan's lease portfolio increased from \$52 million at the end of 2003 to \$74.4 million at the end of 2004, primarily due to Uzselhosmashleasing's operations. Commercial banks' leasing portfolio increased by almost 2 fold.

Leasing arrears are not significant in Uzbekistan, composing only 1.9% of the total lease portfolio in the country in 2004 (2.2% as of the end of 2003). Also, during the last two years, there have been practically no leased asset repossessions or debt transfer to new lessees.

Leased assets

Agricultural equipment continues to dominate the leasing industry in Uzbekistan. In 2003, 70.3% of leases written were for agricultural equipment (75.2 in 2003). This is, of course, mainly due to Uzselkhozmashleasing; however, even excluding



Leased Assets
(excluding Uzselkhozmashleasing)

Uzselkhoz mashleasing, agricultural equipment accounted for 17% of the market.

Analyzing the market without Uzselkhoz mashleasing's portfolio, production equipment composes 45% of the total lease portfolio (29% in 2003). Real estate leasing figure is 17%, which is explained by the willingness of the lessors to optimize taxation. In quantitative terms, most of leases are for agricultural and production equipment and passenger vehicles.

Lease term and leased assets value

In Uzbekistan, the average lease term is up to three years (except for Uzselkhoz mashleasing where 80% of its transactions are for 7 years). This can be explained by the high interest rates charged by several lessors (clients are eager to make the repayment as soon as they can in order to pay less interest) and also the lack of long-term financing available in Uzbekistan.

The average lease size in 2004 was \$15,000 which is almost the same as in 2003; however, the average lease size depends significantly upon the lessor financing the lease. Karakalpakstan Business Incubator and the Association of Women's Business Karakalpakstan finance leases for under \$12,000, whereas Business Bank, Uzbek Leasing International and Business Leasing have average transaction sizes of more than \$140,000.

Sources of finance

Commercial banks are financing leases directly, and therefore in Uzbekistan, there are no leasing companies which are wholly owned subsidiaries of the banks.

Leasing companies finance their operations from their own funds and from shareholder loans (with the exception of Uzselkhoz mashleasing which is financed from a special Fund under the Ministry of Finance)

Perspectives

IFC's research demonstrates that leasing in Uzbekistan has great potential. The greatest demand is for agricultural and agricultural processing equipment, followed by equipment for light manufacturing and food manufacturing. Retail trade equipment, which also has potential in Uzbekistan, is a largely untouched market.

The progressive climate for leasing combined with the liberalization of the currency market in Uzbekistan has created the foundation for the further development of leasing. Nevertheless, this growth cannot be fully realized without new external funding sources, or without internal restructuring by Uzbekistan lessors to update their marketing, credit analysis and monitoring to meet the growing competition in the market.

LEGAL FRAMEWORK FOR LEASING IN UZBEKISTAN

Leasing is governed in Uzbekistan by the Civil Code, which was adopted in August, 1996 and the Law on Leasing which was adopted on April 1999. Both Civil Code and the Law on Leasing were amended in December 2002 to create a more progressive legislative framework for leasing. Also on August 30th, 2003 the Uzbekistan Parliament adopted amendments to the Code for Economic Litigation Procedures to simplify and strengthen repossession procedures for leased assets.

Uzbekistan has signed and ratified the UNIDROIT Convention which governs international leasing, and came into effect in Uzbekistan on February 1, 2001. The UNIDROIT Convention serves as the governing basis for international leasing operations and takes precedence over Uzbekistan law and regulation only in those cases in which the lessor and the lessee are located in separate countries.

TAX FRAMEWORK FOR LEASING IN UZBEKISTAN

In Uzbekistan, leasing is on the same taxation “playing field” as bank credit; and in some cases leasing is a more effective instrument from a tax point of view.

Taxation for leasing is based on the same criteria and classifications as stipulated in the Law on Leasing. Finance lease is determined based upon classifications determined by IAS 17. Additionally, all finance leases must be at least 12 months in duration. The tax advantages of leasing are as follows:

- Lease payments are exempted from VAT;
- Manufacturing equipment imported into Uzbekistan for lease is exempt from VAT on import and customs duty, subject to appropriate certification from the importers’ bank;

- The interest payable by the taxpayer for short-term loans only can be deducted from the gross income, but with leasing, the lessor may deduct interest expense regardless of the loan term for all loans borrowed to finance leases;
- When computing the taxable income, the lessee is allowed to deduct:
 - the interest paid on a lease from his gross income regardless of a lease term;
 - the whole amount of accrued depreciation including accelerated depreciation on the leased assets;
- Lessees are not levied property tax on leased assets for the full term of the lease.

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 133-06-53
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E-mail: uzlease@sarkor.uz
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UZSELHOZMASHLEASING

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IFC'S CENTRAL ASIA LEASING PROJECT

Leasing has been an important source of medium and long-term financing for companies, both in developed economies, and in countries with economies in transition. Leasing plays an important role in these countries as an effective means to increase the lessee's asset base, particularly in private and/or new companies and in SMEs, all of which play a key role in introducing innovation and competition in the economy, and result in job creation.

The International Finance Corporation, a member of the World Bank Group, has a long history financing leasing throughout the world. IFC has invested in over 100 leasing companies in 50 different countries (35 in Europe, Middle East and Central Asia). In 25 countries, IFC has initiated the establishment of the first leasing company in that country. IFC's total investment in leasing for the last 30 years has been over \$1 billion.

The International Finance Corporation is working closely with the Central Asia governments, financial institutions and entrepreneurs to help build the leasing industry. With support from the Swiss State Secretariat for Economic Affairs (**seco**), IFC launched the Central Asia Leasing Project (www.ifc.org/centralasia) in late 2001 to create a favorable environment for investment attraction in the leasing sector of the three Central Asian countries (Uzbekistan, Kyrgyz Republic and Tajikistan). The Project expanded into Kazakhstan in fall, 2003 with support from the US Agency for International Development (USAID).

The Central Asia Leasing Project is available to consult with foreign and domestic investors, lessors, lessees, and suppliers on all leasing issues in Central Asia. Please do not hesitate to contact us with any question. For more information, visit the website at www.ifc.org/centralasia or contact Umedjan Umarov and Murat Sultanov in Tashkent at (+998 71) 138 59 25, fax at (+998 71) 138 59 27, e-mails: umarov@ifc.org, msultanov@ifc.org.

The Project in Kazakhstan is closing on March 31, 2005, and in the other Central Asia countries on August 31, 2005.



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STATE SECRETARIAT FOR ECONOMIC AFFAIRS – SECO

The Swiss-IFC Central Asia Partnership Program is being implemented with generous support of the State Secretariat for Economic Affairs of Switzerland (**seco**). Switzerland participates in the international community's efforts to help developing countries. Each year Switzerland spends approximately Sfr 1.5 billion on development aid, a figure which corresponds to about 0.34 per cent of Switzerland's gross national product (GNP).

The State Secretariat for Economic Affairs is responsible for the formulation of Swiss policy on cooperation with developing countries. Together with the Swiss Agency for Development and Cooperation (SDC), **seco** determines what path Switzerland's multilateral policy is to follow, mainly in the form of contributions made to the development countries, channeled through such international organizations as the World Bank, the regional development banks, and the specialized agencies of the United Nations.

seco's objectives in economic development cooperation program are:

- To help developing countries to reach the stage of development most favorable to growth and investment;
- To mobilize private sector resources as a means of increasing the flow of finance to the developing countries, as well as technology transfer;
- To improve the productive and social infrastructure;
- To achieve greater integration of developing countries in international trade.



USAID
FROM THE AMERICAN PEOPLE

US AGENCY FOR INTERNATIONAL DEVELOPMENT – USAID

The USAID - IFC Central Asia Partnership has also launched an initiative in the region, working in Kazakhstan on leasing and in Tajikistan, Kyrgyz Republic and Uzbekistan on microfinance legislative issues with generous support from the US Agency for International Development (USAID). The United States has a long history of extending a helping hand to those people overseas struggling to make a better life, recover from a disaster or striving to live in a free and democratic country. It is this caring that stands as a hallmark of the United States around the world - and shows the world the true character as a nation.

U.S. foreign assistance has always had the twofold purpose of furthering America's foreign policy interests in expanding democracy and free markets while improving the lives of the citizens of the developing world. Spending less than one-half of 1 percent of the federal budget, USAID works around the world to achieve these goals.

USAID has been the principal U.S. agency to extend assistance to countries recovering from disaster, trying to escape poverty, and engaging in democratic reforms. The Agency supports long-term and equitable economic growth and advances U.S. foreign policy objectives by supporting:

- economic growth, agriculture and trade;
- global health; and,
- democracy, conflict prevention and humanitarian assistance.

USAID provides assistance in four regions of the world - Sub-Saharan Africa, Asia and the Near East, Latin America and the Caribbean, and Europe and Eurasia. With its headquarters in Washington, D.C., USAID's strength is its field offices around the world. The Agency work in close partnership with private voluntary organizations, indigenous organizations, universities, American businesses, international agencies, other governments, and other U.S. government agencies. USAID has working relationships with more than 3,500 American companies and over 300 U.S.-based private voluntary organizations.

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