**VORONEZH SPICE CAKES**

Aromatic spice cakes. Gingerbread cookies generously sprinkled with nuts. Cookies of all shapes and sizes. Chocolate rings. All of this delicious magnificence from the Knyazev Bakery is in hot demand throughout Voronezh.

If the founders' descendants ever write a history of the family business, they will be justified in calling it a pioneer among Russian small enterprises: Oleg Shulga and Yulya Chirkina started selling cookies as soon as private enterprise was legalized in Russia. At first they sold the standardized pastries of the local Soviet-era bakeries, but they quickly realized that they could achieve much more by introducing something new to the market. And so the young entrepreneurs, brimming with enthusiasm, decided to make their own pastries. But this turned out to be more complicated than they had anticipated.

At first they tried to borrow money to set up their own pastry kitchen, but no one would give them a loan, citing their inexperience and lack of collateral. Confectionery equipment is quite expensive, so there was simply no way that the partners could afford it on their own. The local confectionery industry was already on the verge of collapse, but the old equipment was still chugging along; a few repairs here and there, and a bakery could carry on.

*Continued on pg. 17*
How free is a Russian leasing company, under current conditions, to choose its own development strategy?

Which factors influence a leasing company’s choice of leasing projects? Should it specialize in one industry or type of equipment? In this article, we will try to answer all of these questions.

Leasing companies can choose between two basic approaches to building a portfolio: the universal approach (i.e., not specializing in any particular industry or type of equipment), or the specialized approach. Specialization can take the following forms:

• a single industry
• a single type of equipment
• a single geographical area
• a single type of client (i.e., small and medium-sized businesses or large enterprises).

An analysis of the Russian leasing market reveals that, in addition to the universal leasing companies, such as St. Petersburg’s Baltisky Leasing and Moscow’s RG Leasing, there are many leasing companies that limit their portfolios to a particular specialization. For example, the Moscow Leasing Company only leases to small enterprises, while Leasing-Motors of Moscow specializes in motor vehicles. How do companies choose their specializations? What kind of risks does this specialization entail, and how can a company minimize them?

The Industry Approach

A leasing company can choose to specialize in a particular industry, such as agriculture, petroleum or forestry. That is, the company can choose to serve only one industry, while continuing to provide that industry with a wide range of equipment — from specialized machinery to office computers and vehicles.

Rosagrosnab (Russian Agricultural Equipment), Lizingugol (Coal Leasing) and RTK Leasing are completely different leasing companies, but each of them structures its lease portfolio according to the same principle: specialization within a single industry. Rosagrosnab and Lizingugol both tap government funding for certain industries (agriculture and coal, respectively) to finance their leases. It is hard to call these commercial enterprises, since many of their projects do not make any profit; rather they are operators that distribute government funding earmarked for particular industries. RTK Lizing, which specializes in telecommunications equipment, is a truly commercial enterprise, but its specialization was predetermined at birth: it is a subsidiary of Rostelekom.

In this article we continue our ongoing series of publications on risk management for leasing companies. This month we look at how leasing companies can build their lease portfolios to minimize risks.

Veronika Shtelmakh, Economist
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November—December 2000

THEORY & PRACTICE

How leasing companies can minimize their portfolio risks

Veronica Shtelmakh, economist, IFC Leasing Development Group

In this article we continue our ongoing series of publications on risk management for leasing companies. This month we look at how leasing companies can build their lease portfolios to minimize risks.
All three of these leasing companies were created by other agencies or organizations to serve particular industries. But there are also leasing companies that had already been working for some time when they decided, for one reason or another, to specialize in a particular industry. For example, Moscow's Prodmashleasing decided to specialize in the meat and dairy industry. According to the company's financial director, G.Yu. Vorobeychuk, the company chose this specialization because most of its staff had worked in closely related industries, where they had already developed useful contacts. One of the benefits of working with agricultural firms is their relative quick turnover, which makes them relatively solvent clients. But there is also a down side: both the cost of raw materials and the demand for agricultural products are seasonal, and this must be taken into account when calculating the lease payments.

**Suggestions on How to Minimize Risk**

When a leasing company decides to specialize in a particular industry, it must first research that industry's current conditions and development trends. It must also learn about the industry's production cycle, the state of its equipment base, and whether it has any monopolies or major investors.

In addition to these basic features, the leasing company must also study such factors as industry-specific risks (e.g. environmental laws), tax treatment, and the degree and nature of criminal involvement. It is also important to understand the government's interest in, and influence on, the industry's development. A strong interest on the part of the government can play either a positive or a negative role. On the one hand, leasing companies that operate within a given industry may receive government support in the form of subsidies, cheap loans, etc. On the other hand, this may make it difficult to repossess equipment if the lessee fails to make his lease payments, since the local government will almost certainly take the lessee's side, not the leasing company's.

Some industries are particularly vulnerable to currency risks. Transportation firms, for example, were hit especially hard by the financial crisis of 1998. Food-processing companies, on the other hand, did not suffer as badly, according to some leasing companies.

Leasing companies must also be aware of their competitors in a given industry. If a large new competitor appears on the scene unexpectedly, the leasing company may have to fight for its own survival.

**The Equipment Approach**

Leasing companies may choose to specialize in a particular kind of equipment, such as vehicles, office equipment or bank equipment.

Typical representatives of this approach include Daimler Chrysler Service (debis) Automobile Leasing, or Anker Industrial Leasing Company of St. Petersburg, which specializes in cash registers. These companies were specifically created by producers of a given type of equipment as a means of boosting sales.

Then there are leasing companies that specialize in particular kinds of equipment for other practical reasons, regardless of the founders. For example, Kreditimpeks Leasing Company, which was founded in 1996, began leasing automobiles because they were highly liquid assets. This made it much easier for Kreditimpeks to obtain financing, since banks require far fewer guarantees when the leased asset is so liquid. The company's director, A.P. Mokin, says that such a narrow specialization does not hinder the company's growth, because it is free to diversify within a broad range of vehicles.
In the last issue of the Leasing Courier (Special Edition 2000), we considered what might happen to the Russian leasing market if Part II of the Tax Code was adopted. At that time, the Chapter on Profit Tax had already passed first hearing in the Lower House (16/04/98).

In October, two new drafts of the Chapter on Profit Tax were submitted to the State Duma.

**THE NEW TAX CODE: PROGRESS OR THE DEMISE OF RUSSIAN LEASING COMPANIES?**

*An analysis of the drafts of Part II, Chapter 25 of the RF Tax Code, submitted to the State Duma in October 2000*

Elena Degtyareva, Financial Analyst
IFC Leasing Development Group

Suggestions on How to Minimize Risks

Specializing in one kind of equipment has several advantages. First of all, by working out a fixed set of lease plans, the leasing company can save money on project development. Second, the leasing company develops a constant, stable relationship with suppliers, and may therefore qualify for various bonuses, discounts or payment deferrals. Finally, the leasing company's employees become experts on a given kind of equipment, which may enable the company to expand its services to include such things as assistance with mandatory automobile inspections.

The disadvantage to this kind of specialization is that it makes the leasing company highly vulnerable to fluctuations in demand, to changes in tax laws, to environmental standards, and to any other risks associated with their particular kind of equipment.

For example, a rise in import tariffs can hurt companies that lease foreign automobiles (but will obviously help companies that lease Russian cars).

**Specialization leads to stable contacts and discount rates. But it also carries the danger of concentrated risks. Leasing companies must diversify their portfolios.**

P.V. Kelmanov,
Financial Director of Leasingbusiness

**In the next issue we will discuss other approaches to building a lease portfolio - by geographical area, volume of financing or type of enterprise. We will also share the IFC Leasing Development Group's recommendations on ways to minimize portfolio risks.**

The following sources were used in this article:

- «A Brief Directory of Russian Leasing Companies» (3rd Edition), International Finance Corporation
- Internet site www.RTC-Leasing.ru

Our thanks to the leasing companies that were so kind as to share information about their activities.

Our special thanks to I.M. Chuvileva, head of the finance department of RG Leasing, who helped us prepare this article.

In the next issue we will discuss other approaches to building a lease portfolio - by geographical area, volume of financing or type of enterprise. We will also share the IFC Leasing Development Group's recommendations on ways to minimize portfolio risks.
The first was submitted by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik on October 5. According to the newspaper Vedomosti (November 3, 2000), the bill was written under the direction of A.M. Makarov, head of an expert council on tax laws within the State Duma's Committee on Taxation and the Budget.

A second bill was submitted to the Duma on October 25 by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin. This bill was drafted under the direction of S.D. Shatalov, Russia’s deputy minister of finance.

Each of the bills gives serious cause for concern, as they both retain certain features of the 1998 bill that could have serious negative consequences for the development of leasing in Russia; namely:

- a new policy on depreciation
- a new tax policy for loan interest (restrictions on tax deductions based on the «rate of capitalization» and the lender’s share in the borrower’s charter capital).

These statutes are common to both bills, but there are also a number of differences between the two. Let us consider in more detail the possible effects of the two bills on the future development of leasing in Russia.

**DEPRECIATION POLICIES**

**Depreciable Assets**

Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)

Article 259. Clause 1. Depreciable property is defined as tangible or intangible assets held by the taxpayer (on the basis of the right of possession, use and disposal), from which said taxpayer derives economic benefit and whose value is fully depreciated through depreciation deductions.

Statute proposed by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin (Ministry of Finance bill)

Article 259. Clause 1. Depreciable property is defined as tangible or intangible assets held by the taxpayer (on the basis of the right of possession, use and disposal), from which said taxpayer derives profit and whose value is fully depreciated through depreciation deductions.

Both bills restrict the definition of depreciable property to those assets which are held by the taxpayer «on the basis of the right of possession, use and disposal.» In other words, property cannot be considered depreciable unless the taxpayer has all three of these rights. Under a lease, however, these rights are distributed between the two parties: the lessee has the right of possession and use, while the lessor retains the right of disposal. Therefore, both bills preclude the depreciation of leased assets.

The definition of depreciable assets must clearly be expanded to state that leased assets also qualify for depreciation by either the lessor or the lessee.

**Bookkeeping for Leased Assets**

Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)

Article 260. Clause 2. Assets leased under a financial lease agreement should be included in the appropriate depreciation category and should be recorded on either the lessor’s or the lessee’s balance sheet (as stipulated under the lease agreement) at the value indicated in the lease agreement. The party not recording the leased asset on its balance sheet accounts for it off-balance sheet.

Statute proposed by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin (Ministry of Finance bill)

Assets leased under a financial lease agreement should be included in the appropriate depreciation category and should be recorded on the lessor’s balance sheet at a value equal to the expenses incurred by the lessor in purchasing the asset and preparing it for useful service. The party not recording the leased asset on its balance sheet accounts for it off-balance sheet.

The Makarov bill retains the current norm allowing parties to choose whether to record the leased asset on the lessor’s balance sheet or the lessee’s. However, it also introduces a new problem: the unexplained notion of «the value indicated in the lease agreement.» If this means the sum of the...
lease payments, then it contradicts the definition of depreciable assets («expenses incurred by
the lessor in purchasing the asset and preparing it for useful service»).

The Ministry of Finance bill implies that the leased asset can only be recorded on the lessor’s ba-
 lance sheet. However, the bill then goes on to contradict itself: «in the event that the leased asset is
recorded on the lessee’s balance sheet...» (see the article on «other expenses»), which implies that
the freedom to choose accounting methods is preserved.

The authors might have eliminated this contradiction and allowed parties to record the lease as-
 set on either the lessor’s balance sheet or the lessee’s, thereby confirming the relevant statute of
the Federal Law on Leasing.

Depreciation of Motor Vehicles

**Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)**

Motor vehicles (land, air or water) used for the trans-
 portation of people belong to the fifth category of assets re-
gardless of their value, unless such transportation is the
entity’s primary activity.

**Statute proposed by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin (Ministry of Finance bill)**

Article 259, Clause 5. Motor vehicles (land, air or water)
used for the transportation of people should be classified in
the appropriate depreciation category depending on their
conditional book value.

A positive difference between such vehicles’ original
book value and their conditional value is not considered
a loss and does not diminish the taxable base.

The same regulations apply to property received as a
contribution to charter capital.

The Ministry of Finance bill implies that the conditional value of a motor vehicle, not its real value, deter-
mines the size of depreciation allowances for tax purposes. For example, passenger cars with a real val-
ue greater than 200,000 rubles (about $7,000) are deemed to have a conditional value of 200,000 rubles
or 50% of the original value (whichever is higher). For mini buses or vans, the conditional value is 300,000
rubles (about $10,000) or 50%. For other kinds of vehicles, the conditional value is 50% of the original.

The purpose of this statute is to limit the size of depreciation allowances claimed as tax deduc-
tions. But it fails to clarify some accounting matters for motor vehicles or to provide a definition of
the taxable base for property tax when motor vehicles are sold, etc.

Depreciation of Property Recorded in the Books Prior to Implementation of the Chapter

**Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)**

Article 261. Clause 4. This clause establishes norms for
the depreciation of property already recorded in an entity’s
books prior to the implementation of this chapter of the RF
Tax Code. These norms differ from those pertaining to oth-
er property and from those currently in effect.

This bill does not uphold current depreciation norms for
property already under lease at the moment of the relevant
chapter’s implementation.

**Statute proposed by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin (Ministry of Finance bill)**

Article 260. Clause 4. This clause establishes norms for
the depreciation of property already recorded in an entity’s
books before introduction of the RF Tax Code. These
norms differ from those pertaining to other property and
from those currently in effect.

Article 260. Clause 5 (last paragraph). Entities that
recorded leased fixed assets on their balance sheets and
received such assets before implementation of the current
chapter of the Tax Code may assign these assets to a sub-
group of the appropriate depreciation category. Deprecia-
tion of these assets should be calculated separately for
each unit in accordance with the methods and norms that
were in effect when the assets were recorded on the bal-
ance sheet, using the acceleration rate appropriate to
these assets, as stipulated under the lease agreement.
In both bills, the depreciation norms for property recorded on the balance sheet prior to implementation of the current chapter of the Tax Code (before introduction of the Tax Code itself in the case of the Makarov bill) differ from the norms for other assets.

The Makarov bill does not stipulate that property already under lease at the moment of the chapter’s implementation may be assigned to separate subgroups. The phrasing of the clause implies that property falls into the subgroup of the property recorded on the balance sheet prior to implementation of the RF Tax Code, and that the property is consequently subject to new depreciation norms.

We should add that the depreciation norms for property already recorded on the balance sheet are dramatically different from current norms and those that served as the basis for calculating the duration of the lease and the size of the lease payments. As a result, leasing companies will have to reevaluate the conditions of their current agreements; otherwise these deals will become financially infeasible. The changes they make will clearly not benefit lessees.

For property already under lease at the time of the chapter’s implementation, it would clearly make more sense to preserve the depreciation policies that were in effect when the deals were signed, as proposed in the Ministry of Finance bill.

Special Depreciation Norms

The Makarov bill only stipulates special depreciation norms for fixed assets that are employed under intensive conditions or higher shift indices.

The Ministry of Finance bill extends special depreciation norms to leased assets as well. This enables companies to write off the value of a leased asset through depreciation allowances over a shorter period, but it fails to solve the basic problem.

As everyone knows, it is nearly impossible to obtain a bank loan for longer than three years in Russia today. Yet bank loans are the primary source of financing for Russian leasing companies. By using the linear method of depreciation with an acceleration rate of 3, leasing companies are currently able to pay off their loans over the course of the lease agreement (which rarely exceeds 3-4 years).

After consulting with Russian leasing companies about the effects of depreciation policies, we are proposing the following:

1. Use the linear method of depreciation along with the norms stipulated under the Tax Code bills. For example, for machinery and equipment classified under the fifth category of assets, the annual depreciation norm is 24% (or 28.8% if special depreciation norms apply). The lease term is 4 or 3.5 years accordingly.

The Ministry of Finance bill only stipulates special depreciation norms for fixed assets that are employed under intensive conditions or higher shift indices.

If the depreciation policies of the current bills are adopted, this will lead to a significant increase in the length of leases, which is unacceptable to leasing companies.

After consulting with Russian leasing companies about the effects of depreciation policies, we are proposing the following:

1. Use the linear method of depreciation along with the norms stipulated under the Tax Code bills. For example, for machinery and equipment classified under the fifth category of assets, the annual depreciation norm is 24% (or 28.8% if special depreciation norms apply). The lease term is 4 or 3.5 years accordingly.

In other words, the Tax Code should also allow entities to choose from among four methods for calculating depreciation: the linear method; the declining balance method; the method of deducting value according to the number of years of useful service; and the method of deducting value in proportion to sales volume.

This would allow taxpayers to choose the calculation method most suitable to them.

3. To raise the depreciation norm for the third category of assets (machinery and equipment) from 2% to 2.5%, and, consequently, to increase the special depreciation norm to 3% (maintaining the same factor of 1.2 between the main depreciation norm and the special norm).

Raising the depreciation norm to 2.5% would lower the useful service life of assets in the third category to 7.5 years (compared to 9.5 years under the Ministry of Finance bill). The useful service life of a leased asset in this category would be 6 years. Most of the leased asset’s value (80%) would be written off within four years. Introducing a single useful service life of 9.5 years would only help certain industries, enabling them to write off obsolete assets more quickly. Other industries, such as agriculture, medicine, biotechnology, coal, petroleum, and forestry would suffer, since they can write off their fixed assets more quickly under current regulations.

We should add that the last two proposals, unlike the first, apply to all property, not only to leased assets.

Clearly, the most attractive solution (and not only for the leasing industry) would be to give entities the freedom to choose a depreciation method for tax purposes, as currently stipulated in the Accounting Standards. We realize, however, that this is also the most radical proposal, one that goes against the underlying principles of the Tax Code bill, giving taxpayers the freedom to choose between depreciation policies and, consequently, tax strategies.

Determining the Residual Value of an Asset

**Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)**

Article 262. Clause 1. The following formula should be used to calculate the residual value of assets in depreciation categories 1 and 2:

\[ S_n = S (1 - 0.01 k^* n) \]

Article 262. Clause 2. The following formula should be used to calculate the residual value of assets in all other depreciation categories:

\[ S_n = S (1 - 0.01 k)^n \]

**Statute proposed by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin (Ministry of Finance bill)**

The same formula should be used to calculate the residual value of all assets regardless of their depreciation categories:

\[ S_n = S (1 - 0.01 k)^n \]

The Makarov bill stipulates that the linear method should be used to calculate the residual value of assets in depreciation categories 1 and 2 (buildings and structures), while the declining balance method should be used for all other categories.

As we have already noted, it would be a positive development for the leasing industry if this approach to calculating depreciation were extended to include leased assets (see the preceding section on «Special Depreciation Norms»).

However, this approach is unlikely to work unless further changes are made to the definition of depreciation allowances (which the Makarov bill fails to do), since this statute would otherwise conflict with Article 261, Clause 2. Clause 2 defines monthly depreciation allowances as a percentage of the monthly summary balance of each depreciation category in accordance with its depreciation norm. According to Article 260, Clause 8, the summary balance of each depreciation category decreases every month by the sum of depreciation allowances claimed during the preceding month; that is, it equals the residual value of the property. Thus, Articles 260 and 261 stipulate that the diminishing remainder method should be used to calculate the depreciation allowances for all depreciation categories, while the proposed formula stipulates the linear method for some categories.
This contradiction ought to be eliminated, along with the procedures for calculating depreciation allowances for these categories (or subcategories) of assets as a percentage of the original value, rather than the residual value, in accordance with the depreciation norm.

The Useful Service Life of an Asset and Writing off Its Residual Value

Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)

Article 262. Clause 3. When the residual value of a depreciable asset reaches a limit of no less than 5,000 rubles, the taxpayer may write off the asset through depreciation allowances for the following month after the limit was reached. The remaining balance for the appropriate depreciation category should be reduced by the same amount for that period.

The Makarov bill implies that entities may write off the value of an asset at any time and, in so doing, lower their taxable base. It is possible that the authors meant to say «no more than 5,000 rubles,» but this would create a problem of another sort: the depreciation period would depend on the original value of the asset. For example, an asset in the third group (machinery and equipment) worth 15m rubles (about $500,000) would depreciate over 30 years, while an asset worth 150,000 rubles (about $5,000) would depreciate in 14.

The Ministry of Finance bill avoids this problem: the service life does depend on the asset's original value. However, «removing the asset from the depreciation category as a physical unit without reducing the balance of this depreciation category» means that entities will be left with a significant balance in the respective depreciation category. For example, equipment worth 15m rubles will still have a residual value of about 1.5m rubles after 9 and a half years. Furthermore, the remaining value will continue to depreciate, since depreciation is deducted from the balance itself. It remains unclear how entities should calculate their property tax, how they should continue to claim depreciation allowances, and when they should write off the remaining value of an asset.

TAX ON INTEREST

Statute proposed by Deputies V.K. Gartung, V.M. Dubov and G.V. Kulik (the Makarov bill)

Article 274. Clause 1. Entities may claim tax deductions for interest paid on loans within the limits of standard interest rates.

Article 274. Clause 2. If an entity owes more than three times its own capital in loans and the lending institution contributed less than 20% of the entity's charter capital, then the tax deductions for interest paid on loans are calculated based on the maximum size of the entity's unpaid debt. This is calculated as the product of the entity's own capital (defined on the basis of the shareholder's share of the entity's charter capital) multiplied by 3.

In other words, deductible interest on loans is defined as:
Interest * Shareholder's share * Own capital

An entity's unpaid debt does not include indebtedness to buyers, customers, suppliers, contractors, the government or off-budget foundations.

Statute proposed by Deputies V.M. Reznik, V.I. Golovlyov and S.I. Shtogrin (Ministry of Finance bill)

Article 294. Clause 1. Entities may claim tax deductions for interest paid on loans within the limits of standard interest rates.

Article 294. Clause 2. If an entity owes more than three times its own capital in loans and the lending institution contributed less than 20% of the entity's charter capital, then the tax deductions for interest paid on loans are calculated based on the maximum size of the entity's unpaid debt. This is calculated as the product of the capitalization rate multiplied by the sum of the entity's own funds (defined on the basis of the shareholder's share of the entity's own capital).

In other words, deductible interest on loans is defined as:
Interest * Own capital / Borrowed capital * Shareholder's share * Own capital
The notion of «unpaid loans» is not defined.
Both bills place restrictions on tax deductions for interest paid on loans based on the ratio of capital to unpaid loans and the lender's share of the entity's charter capital.

Loans will always make up a larger part of total liabilities for leasing companies than for other kinds of entities. Furthermore, in order to minimize the risks of leasing, the lenders are often shareholders in the leasing company.

If these new restrictions are implemented, they will raise the cost of leasing and, consequently, make leasing less attractive than other forms of investment.

The Makarov bill places softer restrictions on tax deductions for loan interest than the Ministry of Finance bill. Furthermore, the Makarov bill stipulates that indebtedness to suppliers, the government and off-budget foundations does not count towards the sum of borrowed funds. The Ministry of Finance bill does not specify what is to be included in the sum of borrowed funds; the notion of unpaid loans is therefore open to a broader interpretation, which means that the sum of an entity's own capital will be lower and the tax restrictions narrower.

Let's take a look at how these restrictions will effect the size of tax deductions for interest paid on loans.

We shall assume the following conditions:

Shareholder's share of charter capital (S) = 40%
Own capital (OC) = 200
Loan capital (LC) = 800
Loan interest (I) = 10%
Capitalization rate (CR) = OC/LC = 200/800

Here we have two of the essential conditions: loan capital exceeds own capital by more than 300%, and the shareholder's share of charter capital is more than 20%. Therefore, we must calculate the maximum sum of indebtedness for which we can claim interest deductions.

The Bill Proposed by Deputies Gartung, Dubov and Kulik
Maximum sum of indebtedness = S • OC • 3 = 40% • 200 • 3 = 240.
Therefore, we may deduct no more than 10% • 240 = 24.
The total sum of interest paid on loans is 80. We are therefore left with 80 - 24 = 56, which we must pay out of our own funds.

The Bill Proposed by Deputies Golovlyov, Reznik and Shtogrin
Maximum sum of indebtedness = CR • S = 200/800 • 40% • 200 = 20 (!).
Therefore, we may deduct no more than 10% • 20 = 2.
Out of our own funds we have to pay 80 - 2 = 72.

In this example, the Ministry of Finance's formula allows us to deduct 12 times less (!) interest than the Makarov formula.

We should add that the Ministry of Finance bill also includes Article 294, Clause 4, which was not included in the Makarov bill. This clause stipulates that if the loan capital provided by the lender exceeds the allowable sum of indebtedness (calculated as the capitalization rate multiplied by its own capital, which in turn is based on the shareholder's share of charter capital), then the entity may deduct interest paid on the part that does not exceed the allowable sum of indebtedness.

In other words, this clause does not impose any restrictions on the basis of the proportion of own capital to loan capital or the lender's share of charter capital, as stipulated under Clause 2, but rather
introduces a new restriction: the allowable sum of indebtedness. If the sum of loan capital is greater
than the product of the capitalization rate • lender’s share of charter capital • own funds (i.e., the al-
lowable sum of indebtedness), then entities may deduct interest paid on the maximum sum of indel-
bedness. The formula would look like this: \( \text{LC} < \text{OC} \cdot \text{LC} \cdot \text{S} \cdot \text{OC} \). We can rewrite the formula as follows:

\[ \text{LC} < \text{OC} \cdot \text{S}^{1/2} \]

In other words, all of the interest paid on loans may be deducted if the loan capital does not exceed the product of own capital • the square root of the lender’s share of charter capital.

Consider the following example:

- Shareholder’s share of charter capital \((S)\) = 1%
- Own capital \((\text{OC})\) = 200
- Loan capital \((\text{LC})\) = 400
- Loan interest \((\text{I})\) = 10%

Thus, the allowable sum of indebtedness = \(200/400 \cdot 1\% \cdot 200 = 1\).

All that we can deduct for interest paid is 10\% \cdot 1 = 0.1.

The remaining 39.9 we must pay out of our funds.

Thus, the Ministry of Finance bill would tax interest as follows. Article 294, Clause 2 would limit in-
terest deductions if loan capital exceeded own capital by more than 300\% and the lender’s share of
charter capital exceeded 20\%. But Clause 4 would place major restrictions on interest deductions
even if loan capital did not exceed own capital and the lender’s share of charter capital was infini-
tesimally small.

In other words, not only does Article 294, Clause 2 of the Ministry of Finance bill defy logic, but
Clause 4 of the same article does so even more spectacularly.

We can see how much the proposals differ in their interest deduction policies. It is interesting to
compare them to the draft that passed its first hearing in the State Duma on July 16, 1998. That draft
took an entirely different approach. Unlike the current drafts, which define the rate of capitalization
as the ratio of own capital to loan capital, the 1998 draft defined it as the ratio of loan capital to own
capital (i.e., the complete opposite).

Let’s apply that formula to our example:

- Maximum sum of indebtedness = \(\text{CR} \cdot \text{S} = 800/200 \cdot 40\% \cdot 200 = 320\).

Thus, we may deduct no more than 10\% \cdot 320 = 32.

From our own funds we have to pay 80 - 32 = 48.

As you can see, the 1998 draft placed softer restrictions on tax deductions for interest paid on loans.

But neither the old draft nor the current ones manage to create logical restrictions on interest de-
ductions. If their goal was to discourage lenders with a vested interest from granting loans, then they
hardly succeeded, since, as we have seen, the larger the lender’s share of charter capital, the larg-
er the interest deductions and, consequently, the lower the profit tax.

Furthermore, if the lender’s share of charter capital remains constant but the loan capital diverges even
slightly from the allowable maximum (three times the entity’s own capital), then the sum of the interest
deductions changes dramatically. We can demonstrate this using the Makarov bill as an example.

<table>
<thead>
<tr>
<th>Own capital</th>
<th>Lender’s share</th>
<th>Loan capital</th>
<th>Maximum sum of indebtedness</th>
</tr>
</thead>
<tbody>
<tr>
<td>1000</td>
<td>30%</td>
<td>2999</td>
<td>900</td>
</tr>
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</table>

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<tbody>
<tr>
<td>1000</td>
<td>30%</td>
<td>3000</td>
<td>3.3 times lower (!) (calculated as 30% \cdot 1000 \cdot 3).</td>
</tr>
</tbody>
</table>
Creating equal tax conditions for all taxpayers may cause serious damage to the leasing industry.

In our opinion, all three of the bills need to rework their definitions of interest deductions. The most acceptable solution from the point of view of leasing companies would be to allow interest deductions regardless of the rate of capitalization or the lender’s share of charter capital.

In conclusion we would like to point out that the underlying principle of the new Tax Code (to make the taxation system «fair» and create an equal playing field for all taxpayers) can cause serious damage to the leasing industry, as it fails to take into consideration the special nature of leasing as a form of investment. It would be perfectly fair to create a special article of the Tax Code just for leasing transactions, as has been done for other kinds of financial services (the banking sector, pension funds and securities markets).

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FOREIGN LEASING LAW

Olga Shishlyannikova, Lawyer
IFC Leasing Development Group

Continued from Issue #11

The Lease Term

The very essence of a lease agreement presupposes that the duration of the lease will be commensurate with the useful life of the leased asset or its depreciation period. However, the concept of a «commensurate period» is vague and requires a concrete legal definition.

The duration of the lease is defined by the lease agreement. If the lease agreement does not specify the duration of the lease, the lease is deemed valid for an indefinite period. The maximum term of a lease may be established under the law for certain kinds of leases or for certain kinds of property (Article 610 of the Civil Code of the Russian Federation).

Principal changes proposed under the draft Chapters on Profit Tax:
- New depreciation policies for tax purposes
- New procedures for calculating loan interest deductions (the notions of «standard interest rate» and «rate of capitalization» are introduced)
- Maximum rate of profit tax for all entities is capped at 30% (35% prior to implementation of the Chapter on Municipal Tax)
- Taxpayers are allowed to carry losses forward for up to ten years (including losses on securities)
- Insurance and advertising expenses may be included in expenditures when calculating the taxable base
- Financial tools for forward transactions are clearly defined; they may be revalued and their losses may be carried forward.
Great Britain does not impose any restrictions on the duration of a lease. In actual practice, however, the lease term rarely exceeds the useful life of the leased asset.

Canada, as well, places no restrictions on the duration of a lease. There are, however, some practical limitations. The fact that lease payment schedules are usually determined in part by the service life of the leased asset is one such limitation. Another is that certain restrictions are placed on banks, insurance companies and trusts (see the sections on the Leased Asset and the Leasing Parties), which may limit the duration of any given lease agreement.

German law does not place any restrictions on the duration of a lease.

The Czech Republic has established a clear minimum term for leases. Lease agreements must last for at least three years and must exceed one fifth of the depreciation period of the leased asset.

**Lease Payments**

The lessee's principal obligation is to make timely payments for the use of the property (lease payments). The procedures, terms and schedule of lease payments are all determined by the lease agreement (Article 614, Clause 1 of the CC RF). The lessee may sue for early annulment of the lease agreement if the lessee fails to make a lease payment for two consecutive payment periods, as defined under the lease agreement (Article 619 of the CC RF).

The lessee must make timely payments for the use of the property (lease payments). How do other legal systems regulate lease payments, and what can Russian legislators learn from them?

In Canada, the lessee must usually assume responsibility for the lease payments as soon as the lease agreement is signed. Lessees are often required to make down payments on the lease, which are counted towards the final payment. If the agreement is subsequently annulled, the down payment is applied towards the lessee's debts. In addition to the lease payments, many lease agreements also make provisions for a repair fund, in case the leased asset is returned to the lessor in damaged condition. Lease agreements often require the lessee to continue making lease payments even if the leased asset is damaged (including if it is damaged beyond use).

Similar norms exist in Ireland. In most cases the lessee must continue making lease payments regardless of any defects or damage to the leased asset.

The Civil Code of the Czech Republic gives lessors the right to annul the lease agreement if the lessee misses a lease payment and fails to make it by the end of the subsequent payment period.

**Protection of Ownership Rights**

The lessor has the right to impose monetary fines or to repossess the leased asset without court orders under the following circumstances: the lessee has used the leased asset in such a way that violates the conditions of the lease agreement or the intended purpose of the leased asset; the lessee has subleased the leased asset without the lessor’s permission; the lessee has failed to maintain the leased asset in adequate condition, thereby impairing the quality of the asset; the lessee has failed to make a lease payment for two consecutive payment periods, as defined under the lease agreement (Article 13, Clause 1 of the Russian Federal Law on Leasing).

Throughout the world, the leased asset itself serves as the main guarantee for a lease, with the lessor retaining ownership rights for the duration of the contract. In order to protect the
Lessor's ownership rights, legislators in different countries have created a variety of legal mechanisms that enable lessors to repossess their assets from unscrupulous lessees. Russian law also attempts to defend lessors' property rights, but it fails to provide any effective measures for doing so. For this reason, a brief look at the laws of other countries may be very instructive.

Most of Canada's provinces provide legal protection for moveable property. Any leasing transaction that falls under the jurisdiction of Canadian laws for the protection of moveable property must be registered with the appropriate government agency in order to qualify for protection against the lessor's creditors. The lessor also enjoys various kinds of legal protection against lessee default or other contractual violations.

For leasing companies, the most interesting form of protection is the right to seize collateral (usually the leased property itself). This does not normally require a court order, but nor does the lessor have the right to repossess his property independently; he must contract a specialized agent of the court operating through court bailiffs. These bailiffs have the right to enter any property in order to confiscate assets, but they may not enter the lessee's property by violent means without a warrant.

As soon as the leasing company repossesses its property through the mediation of court bailiffs, it is free to sell it or dispose of it in any other way. However, it must notify the lessee and other interested parties of its plans. The lessee has the right to redress his contractual violations up until the moment the property is sold or otherwise transferred, by satisfying the obligations for which the confiscated assets served as collateral and covering any additional expenses incurred by the lessor. Whatever the circumstances, the leasing company must conduct itself conscientiously and observe standard business practices.

An almost identical system obtains in the United States. The lessor may repossess his property without recourse to the courts as long as he can accomplish this without causing a public disturbance. If he cannot, he may appeal to the courts for assistance.

What Happens to the Leased Property after the Lease Expires?

Either the law or the lease agreement itself may stipulate that ownership of the leased property is transferred to the lessee, either before or after the lease expires, provided that the lessee compensates the lessor for the redemption value of the property, as defined under the lease agreement (Article 624, Clause 1 of the CC RF).

The last question we wish to address in this article is the following: Does the Russian lessee assume ownership of an asset leased under a crossborder lease agreement?

In Great Britain, the very definition of a lease precludes the possibility of purchase by the lessee, so the lease agreement should not contain any such provisions. If an agreement does provide for the purchase by the lessee, then it is classified as a sales agreement with a payment deferral, while the lessee is considered to be the owner of the property.

Canada and Germany do not require lease agreements to include provisions for the purchase of leased property.

The Czech Republic and Poland, on the other hand, do make purchase an obligatory feature of lease agreements.

In conclusion, we would like to urge our readers to go beyond this article. Any Russian companies involved in crossborder lease agreement should carefully study the laws of the country that will have jurisdiction over these agreements. This will help Russian firms avoid some unpleasant surprises.

Parts of this article were based on materials prepared by Macleod Dixon of Canada.
OBSTACLES TO THE DEVELOPMENT OF LEASING IN SIBERIA

Vladimir Snegiryov,
General Director of RAPMB Irkutsk Business Park

Most sectors of the Siberian economy grew during the first six months of 2000. Unfortunately, very little of this growth was due to an increase in investment. The largest obstacle to the development of Siberia’s privatized enterprises remains its obsolete and decrepit equipment. Under the circumstances, the most affordable, convenient and profitable means for large and medium-sized enterprises (and probably the only means for small businesses and sole proprietorships) to facilitate their own growth is to lease new equipment.

In Siberia, as in the rest of Russia, leasing began to develop in 1995 when the Federal Statute on the Development of Financial Leasing as a Form of Investment was adopted. Of the 1,500 leasing companies currently operating in Russia, only 150 are registered in Eastern and Western Siberia. Siberian leasing companies account for less than 5% of Russia’s total leasing volume.

How do regional factors affect the lives of leasing companies?

Equipment leasing is a fairly risky form of investment. Leasing companies always prefer to work within the boundaries of their own region, since it becomes difficult and expensive to monitor agreements far away from home. This is especially true in cases where the equipment must be repossessed, as this entails additional expenses for disassembly, transportation and storage.

Furthermore, flaws in the legal system have prevented major Russian leasing companies from setting up branch networks in Siberia.

In order to promote economic development in the regions, the Russian government has adopted a statute on State Support for the Development of Leasing in the Russian Federation, which urges the regions to create favorable economic conditions for leasing companies. This statute was then legally codified under Article 36 of the Federal Law on Leasing (29/10/1998).

Many regional governments have chosen to exempt leasing companies from regional taxes. For example, Tomsk, Kemerovo and Khanty-Mansisk have all reduced their profit tax on leasing companies; Kemerovo and Khanty-Mansisk have lowered property taxes; and Khanty-Mansisk has even reduced the vehicle acquisition tax.

Unfortunately, Irkutsk’s efforts to create better conditions for leasing have not been very successful, and this has certainly had negative consequences. Of the 9 companies that received leasing licenses in Irkutsk, only four have been moderately successful: Irkutsk Business Park, Irkutskoblagrotekhsnab [Irkutsk Agricultural Equipment Suppliers], ROSSO-Kapital and Braz-Lizing.

The unfavorable tax climate has forced ROSSO-Kapital to register in a Free Economic Zone (SEZ) in Ust-Ordynsky, an autonomous okrug of the Republic of Buryatia, while Braz-Lizing has registered in the Republic of Altay. This maneuver makes it possible for these companies to lease automobiles in Irkutsk on more favorable terms, as their lessees are exempted from the vehicle acquisition tax. For the same reasons, Irkutsk Business Park leases automobiles through the Moscow Leasing Company (the municipal government of Moscow has also exempted leasing companies from the vehicle acquisition tax).

As a result, Irkutsk loses tax revenue and its investment statistics are distorted.

One of the biggest obstacles to the development of leasing in the regions is the fact that banks, investors and the federal and regional governments have been unwilling to provide leasing companies with long-term loans.
Ideally, a lease should last for the entire depreciation period of the leased equipment (usually about 3 years if the depreciation rate is tripled in accordance with the Federal Law on Leasing). But banks rarely give loans for more than one year in Russia. In order to pay back such short loans on time, leasing companies are forced to raise the lease payments dramatically during the first year, which in turn raises the leasing companies’ taxes and heightens the risk of lessee default. At the same time, it must obviously be profitable for the banks to finance their clients’ small-scale projects. In leasing companies, the banks should find a more consolidated and reliable borrower to whom it can make relatively secure loans. In order for this relationship to develop, the banks must provide leasing companies with long-term loans (for at least 3 years), and both the federal and regional governments should give them tax incentives for doing so.

One possible way to promote leasing in Russia, and particularly in Siberia, would be to implement the statutes of the Federal Law on Leasing that promised affordable government loans and state guarantees for leases (including deals that involve foreign firms).

Even dramatic improvements to the legal and economic conditions for leasing in Siberia will not be enough to ensure that leasing takes root in the region. Potential lessees will also have to be educated. We are very grateful to the Eurasia Foundation for supporting the Irkutsk Business Development Project.

This project includes seminars and round tables on leasing, consulting aid for leasing projects, and a leasing awareness program, which promotes leasing as an effective means of developing local business, given the lack of collateral for bank loans among local firms and the scarcity of other forms of investment. It is essential for Siberia to have access to investment through leasing if it is to develop its industry, create new jobs and expand municipal budgets.

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**ISYET DENTISTRY**

Isyvet Dentistry, one of the most successful projects of the US-Russia Investment Fund (TUSRIF), was founded in 1997. The center provides full dental services, including therapy, surgery, and preventative treatment, to both children and adults. Its prices are designed for the middle class. Naturally, these prices are somewhat higher than one might find in the state-run clinics, but they are considerably lower than those of private hospitals.

The company was able to obtain all of the facilities and equipment it needed thanks to a hard-currency loan from the US-Russia Investment Fund. This loan was made through TUSRIF’s Loan Program for Small and Medium-Sized Businesses.
Until the financial crisis of 1998, Isyet had been funded entirely through loans. But within a year after they opened for business, the dentists had come to realize that their equipment would not be sufficient for high-quality dental service. If they wanted to raise the level of their services, they would have to acquire more modern equipment. In particular they would need new imaging equipment. While x-rays were once used to obtain multiple images of a patient’s tooth, modern digital X-rays enable the dentist to see the patient’s entire jaw on a computer screen and quickly prescribe the necessary treatment.

Dental equipment, which is usually imported from Europe or America, is quite expensive. After the financial crisis of 1998, Isyet had trouble paying off the rest of its hard-currency loans (it had only paid back 40-50%). At the same time, it badly needed new equipment in order to expand its business. The company did not want to take out yet another loan, which would have plunged it even deeper into TUSRIF’s debt. At any rate, the company would not have been able to provide adequate guarantees.

Iset decided that the best way out of its predicament was to lease some new equipment. It signed a two-year lease with RKM Leasing Center for an American-made digital X-ray machine valued at $9,000. The equipment was delivered in November 1999 and fully assembled and operational by January 2000. According to Isyet’s director, Tatyana Chernyadeva, the new diagnostic equipment has helped the center raise the quality of its services dramatically. Life has also become much easier for Isyet’s patients, since they can now obtain a full range of services at Isyet without having to visit other clinics. The company’s profits have grown by 30%, along with its client base.

Under the lease agreement, the lease payments were calculated to the maximum advantage of the lessee. For the first three months of the contract, Isyet only had to pay interest on the leasing company’s loan. Not until the fourth month did Isyet begin to pay back the principal sum of the loan.

Tatyana Chernyadeva says that her company’s experience with leasing has been very positive. She hopes to use leasing in the future to obtain additional equipment, expand the clinic’s services and improve its quality.

And that is exactly what Shulga and Chirkin did. In August 1999 they managed to rent a small pastry kitchen, with obsolete, decrepit equipment, for a reasonable sum. They spent their own savings on raw materials; even their friends and relatives helped out. The partners got off to an excellent start, and within a few months the kitchen began to turn a profit. By New Year’s, the Knyazev Bakery had managed to pay off all of its debts.
«Finally, we began to get a taste for business,» says director Oleg Nikolayevich Shulga. «We had an impressive collection of recipes, ranging from the exotic to grandma’s traditional, and we began to develop our own recipes and forms. In short, our cookies became more and more interesting and varied. We became so popular that we could no longer keep up with demand (our capacity was limited to 35 tons per month). So we decided that we would have to expand.»

In their search for new funds to expand their business, the entrepreneurs once again turned to banks and private investors. They were either refused for lack of collateral, or they were quoted catastrophically high interest rates. Just when the business was really beginning to take off and the partners had mortgaged their own cars and homes, they couldn’t find the money they needed to take the next step forward.

A leasing company called ReLizKom came to their rescue. The company approached the project very cautiously: first they got to know the partners personally, inspected their equipment thoroughly and checked all of their financial documents. When the leasing company’s experts came to the conclusion that the partners were honest and reliable, they worked out a concrete proposal.

A new production line for spice cakes and cookies would cost $570,000. Most of the components would be Russian, including the rotary oven (a Mussun-Rotor 9.7, manufactured in Samara). The new line would boost production by 5-6 times and allow Knyazev to produce up to 100-150 tons of spice cakes each month.

ReLizKom earmarked two loans of about $300,000 each. In late May 2000, the partners signed a two-year lease. The lease agreement was executed with maximum efficiency: within a month after all the papers were signed, the equipment had already been delivered. Unfortunately, however, the premises were not yet ready: the idle factory that had fallen to the confectioners’ lot was so dilapidated that one floor even had to be weeded. The renovations were taking longer than expected, and as a result the installation of the new equipment was also held up for some time. As the preparations dragged on, ReLizKom lowered the lease payments to give Knyazev a chance to get on its feet and begin producing at full capacity.

The production line finally reached full capacity in October. Whereas Knyazev previously employed only 28 people, it has now expanded its personnel to 50. Another production line has been added to produce shortbread cookies. Altogether the company puts out 14 different kinds of pastries, with 30 more in the offing. All of the recipes have been tried and trued, and the first samples have passed the major taste tests and received the stamp of approval from the State Inspectorate. Oleg Shulga adds with pride that, «According to the ever discriminating Inspectorate, we have the best spice cakes in Voronezh.»

We might add that products of this quality have the potential to sell beyond the local market. Voronezh spice cakes have even

Julia Chirkina shows the leasing equipment: rotary oven «Monsoon-Rotor 9.7» for a batch of sweet production
been tried as far away as Moscow. Knyazev recently earned a certificate of quality at the Sweet Tooth-2000 Exposition held in the Voronezh Expocenter.

Thank to leasing, a small business that started from scratch was able to acquire new, modern equipment. Gradually, step by step, the company has modernized and expanded its production facilities so effectively that it has already grown into a medium-sized business.

By Viktoria Struts

BUSINESS SEMINAR IN KIROV

On October 18-19, the Leasing Development Group, in association with the Kirov Center for the Support of Entrepreneurship and Innovation and the Basis Research Center, held a business seminar on «Leasing in the Regions: Its Future and Potential.» Participants came from 11 different regions of Russia and included representatives of the Kirov regional government and the chief administrators of Kirov’s forest regions; leasing companies, banks and insurance companies; representatives of the timber industry (logging companies, wood-processing companies and major timber suppliers from Kirov, Vologda, Arkhangelsk and the Republic of Komi); and manufacturers of logging and wood-processing equipment.

The purpose of the seminar was to discuss the future of leasing in the Kirov region. Specific topics included the following:

- the principles of leasing and its advantages over other forms of investment
- obstacles to leasing in the region
- ways to implement leasing in Kirov’s timber industry
- business consulting for companies with active leases in the timber industry.

In addition to the timber and pulp industries, Kirov is also home to machine-building, electric power, chemical, petroleum, and food-processing companies. Almost every company in these industries needs restructuring and reequipment. Leasing can make this feasible for both the region’s industrial giants and its small and medium-sized businesses.

Kirov’s leasing industry is only beginning to develop: to date, there is only one registered and active leasing company in the entire region. The Kirov regional government is trying, within the confines of federal law, to create economic conditions that would promote the development of leasing. This year a new bill on Leasing in the Kirov Region was submitted to the regional Duma. The bill provides for various kinds of state support for the local leasing industry, including tax benefits and government-backed guarantees on leases.

At a press conference held immediately after the seminar, State Duma Deputy N.P. Kisilyov spoke to the local media. He explained recent developments in leasing regulation at both the local and federal levels and assured his listeners that the government would do everything it could to promote the development of leasing in Kirov’s timber industry.
THE ANNOUNCEMENT BOARD

Dear readers!

We would like to remind you that the Leasing Courier includes a section called the «Announcement Board,» which was created to accommodate the many people who turned to us for information about potential partners.

Please feel free to post information about your business project on our announcement board. All you have to do is send us a brief description of your project by mail, fax or e-mail (see the back cover for our contact information). The description should include the following information:

- the name of your company or organization and its profile (i.e., lessee, supplier, etc.)
- the relevant industry (i.e., agriculture, aviation, etc.)
- contact information and contact person
- a brief description of the project (no more than four sentences)
- a timetable for the project
- the cost of the project
- potential clients or partners and their location (please indicate if there are any geographical restrictions)
- any additional information that you consider important

In addition to this brief description you may also send us a more detailed text, which we will post on our website.

THE NEW DIRECTORY OF LEASING COMPANIES

This November, the IFC Leasing Development Group published the third edition of its Brief Directory of Russian Leasing Companies. If you are not familiar with this directory, it includes a variety of general information about Russian leasing companies: contact information, types of equipment leased, geographical region of operation, etc.

The first two editions turned out to be extremely useful for both the leasing companies and their clients. Companies continue to request copies of the directory, as well as applications to have information about their own companies included. In order to meet this growing demand, we decided to publish a new edition of the directory.

The third edition reflects the growth trends of the Russian leasing market. It contains information about 62 active Russian leasing companies. We intend to update the electronic version of our directory every two weeks and to post it on our website at http://www.ifc.org/russianleasing. We also plan to publish the directory 2-3 times per year. If you would like to post information about your company or make any changes or additions to information already contained in the directory, please fill out an application (which can be found in every edition of the Leasing Courier) and send it to us, addressed to Svetlana Pletneva.

We would like to emphasize that there is no charge for posting information in the directory. The directory itself is also free. We only hope that it will assist you developing your businesses.

Svetlana Pletneva
Project Assistant
RUSSIAN PRESS DIGEST

The total volume of leasing transactions in Russia is expected to reach 17.5 billion rubles in the year 2000, announced Anatoly Aksakov, deputy chairman of the Duma Committee for Economic Policy and Entrepreneurship, at parliamentary hearings devoted to the «Development of the Russian Leasing Industry,» held on October 3. According to Deputy Aksakov, the volume of lease agreements for high-tech and industrial equipment has increased 200-fold over the last six years. The total volume of leasing transactions, which was less than $2.6m in 1994, reached $493.4m in 1999, according to statistics gathered by the Russian Association of Leasing Companies. As of January 1, 2000, the State Registration Chamber had registered over 1,500 leasing companies (compared to only 20 in 1994). Mr. Aksakov noted that the Federal Law on Leasing, which was adopted by the State Duma in 1998, has played a positive role in the development of leasing in Russia. However, he added, this law no longer corresponds to current economic realities and even creates certain obstacles to the further development of the Russian leasing industry. For this reason, a group of deputies has drafted a bill that would introduce necessary amendments to the Law on Leasing. This bill is currently being reviewed by the administration.

Novosti Russian Information Agency
October 3, 2000

Since it was created nearly four years ago, the Perm Regional Leasing Fund has provided local farmers with 250 million rubles worth of farming equipment and spare parts. The fund has fitted out 9 machine-tractor stations with new equipment and machinery and brought modern, high-productivity machines to the region (including Concord sowers, grain- and fodder-harvesting machines, Claas harvester attachments, Westfalia cattle-breeding equipment, and some new fodder-processing equipment). This year the Perm Region has also leased some stretch film production equipment, which should produce enough of the material in 2001 to meet the needs of the region’s farmers at significantly lower prices. Perm’s leasing program has given priority to technology that raises productivity, such as combined tilling and sowing apparatus (APK-3.8, Ob-4, Lider-4), German-made Smaragd cultivators, and sprinkler systems made with Agro-Patrol-03 parts.

Zvezda [Star], Perm
October 5, 2000

Agricultural equipment supplier Vologdaoblagropromsnab will see its turnover of goods exceeds 400 million rubles this year — an increase of 33%. The relative financial strength of Russia’s agricultural equipment suppliers has enabled them to provide machinery to Russian farmers in exchange for dairy products, meat, and other agricultural goods. One village in the Vologda region has received 600 new tractors this year. Many farms in the region have begun to modernize at a normal rate.

Krasny Sever [Red North], Vologda
October 10, 2000

The Rostov Civil Aviation Plant has leased one of its airplanes to Vladikavkaz Airlines. This is the first step in an effort to restore Rostov’s aviation industry. The Rostov Civil Aviation Plant purchases...
used airplanes, repairs them at its own expense, and then leases them to the airlines. It is the only plant of its kind in Russia that repairs Tu-134s. The plant’s director has already signed a lease agreement with the president of Vladikavkaz Airlines. The mayor of Rostov presented the airline with a key to the aircraft as a token of their new partnership. The aircraft will carry passengers between Moscow and Vladikavkaz and may also be used for international flights, since it meets the aviation standards of every country.

Yuzhny region  
[Southern Region],  
Rostov-on-Don  
October 10, 2000

The KM Leasing Center, founded by the US-Russia Investment Fund, had signed an agreement with the St. Petersburg Bank for Reconstruction and Development. The two institutions have agreed to work together under a single finance program for leases. According to bank representatives, the program will be designed to help small and medium-sized businesses. It will enable such firms to lease fixed assets worth up to $300,000 for periods of up to 3 years.

Dyelovoy Peterburg  
[St. Petersburg Business],  
St. Petersburg  
October 18, 2000

The Agriculture Department of the Yaroslavl Region has created a new leasing fund. Over time, the fund will help local farmers replace their catastrophically obsolete machinery and obtain more high-tech equipment. The region, which will hand out 163 million rubles in subsidies this year, has already placed 28 million rubles of these funds at the leasing fund’s disposal. The fund has begun granting loans to local farmers to help them lease new equipment.

SeverInform [NorthInform], Vologda  
October 26, 2000

According to Deputy Finance Minister Aleksei Ulyukayev, several finance programs currently funded through the federal budget will be transferred to state-owned

A Duma fraction, «The People’s Deputies», have proposed an amendment to the 2001 budget that would create a special agricultural program called «Russian Grain.» The group’s leader, Deputy Gennady Raykov, explained the group’s proposal at a press conference in the State Duma. The deputies propose to distribute agricultural machinery to the regions, in proportion to their acreage of arable land, on the basis of five-year lease agreements backed by the regional governments. The fraction believe that over the course of five years, their 15 billion ruble leasing fund would facilitate the gradual and stable modernization of Russian agriculture to such an extent that the Federal Government would no longer need to subsidize such programs. At the same time, the program would be a tremendous boon to Russian equipment manufacturers.

Novosti Russian News Agency  
October 27, 2000

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banks. Mr. Ulyukayev made this announce-
ment at an international conference on «State
Banks: Problems and Prospects,» recently
held in Moscow. As of next year, Russia’s
state-owned banks will have to provide low-
cost loans to the agricultural and leasing in-
dustries, and especially to projects that involve
both of these industries; i.e., agricultural leas-
ing projects. In order to make this feasible,
says Mr. Ulyukayev, the necessary funds will
be transferred from the federal budget to shore
up the financial position of such state-owned
banks as Rosselkhozbank [the Russian Agri-
cultural Bank] and Rossiysky Bank Razvitiya
[the Russian Bank for Development].

Novosti Russian Information Agency
November 1, 2000

S

t. Petersburg Bank became more active
in the leasing industry during the third
quarter of 2000. Over the last three months,
the bank has granted 63 million rubles in loans
to finance leases for automobiles and office
equipment. This represents a 60% increase in
loans for leasing over the second quarter of
2000. The bank also increased its loans to in-
dividuals by 16% over the same period, fi-
nancing more than 30 automobile leases worth
over 3 million rubles between July and Octo-
ber. According to bank representatives, the
bank still gives first priority to retail and whole-
sale trade, which account for 34% of its loan
investments. Industry takes second place with
19% of the bank’s loan portfolio. Construction
ranks third with 16%.

Delovoy Peterburg,
St. Petersburg
November 1, 2000

T

he Association of Russian Banks (ARB)
has created a special Committee on In-
vestment and Leasing. The new committee will
have broad powers to coordinate the investment
activities of the ARB’s member banks, including
investment through leasing. According to the
ARB, the experience of other nations has
 proven that leasing is an important investment
tool that enables firms to modernize their fixed
assets and create new jobs. Leasing accounts
for up to 30% of total investment in developed
economies. In some transitional economies, this
figure is as high as 80%.

Novosti Russian Information Agency
November 9, 2000

A

other harvesting season has passed
in the Prikamye region. This year, the
region’s farmers have leased (with payment
deferrals of 5-10 years) the following equip-
ment: 120 grain harvesters; 119 fodder-pro-
cessing machines; 140 tractors, including 90
caterpillar tractors; and five sets of German
cattle-breeding equipment that will enable the
new owners to fully automate their production.
Prikamye’s farmers have come up with a plan
to develop the region’s agriculture that will in-
clude all kinds of farms, regardless of their
form of ownership.

Zvezda [Star], Perm
October 21, 2000

D

emetra, a baked-goods producer in the
Novgorod Region’s Borovichi district,
has invested 2 million rubles in renovating
its factory. The renovations are expected to
double the factory’s production capacity, rais-
ing the total output of baked goods (most of
which are sold in St. Petersburg) to 500 tons
per year. The company obtained its new equip-
ment and vehicles through the Novgorod Leas-
ing Company. It expects to pay off these leas-
es within two years. The Novgorod regional
government will provide Demetra with tax ex-
emptions for one year.

Delovoy Peterburg,
St. Petersburg
November 24, 2000

T

he Czech Republic’s ambassador to
Russia, Yaroslav Bashta, accompanied
by a group of Czech equipment manufac-
turers and suppliers, has completed his
tour of the Sverdlovsk region. The Czech
delegation visited the Uralmash, Pnevmostroymashina and Turbomotor plants. The Czech Republic’s leading supplier of industrial equipment, Alta, has agreed to lease a shipment of modern machine tools to Pnevmostroymashina. Turbomotor and Uralmash also plan to sign agreements with Czech firms in the near future in order to modernize their factories. Uralvagonzavod will send a team of experts to the Czech Republic to look into possible agreements. Altogether, the Sverdlovsk Region has signed several million dollars worth of agreements with Czech machine-tool builders. According to the Sverdlovsk Region’s Ministry of International Trade, the renewed delivery of Czech industrial equipment in the Central Urals is extremely important for the whole region, since a large number of plants in the region are in urgent need of renovation.

*Uralsky rabochy [Urals Worker]*

Yekaterinburg
November 24, 2000

Vologdaoblagropromsnab, an agricultural equipment supplier in the Vologda Region, held a leasing conference on November 28. Specialists from 24 Russian regions discussed ways to improve the technological level of Russian agriculture.

*Krasny Sever [Red North]*

Vologda
November 28, 2000

The city of Moscow hosted a CIS Leasing Conference on November 29-30. The conference’s principal organizer, the Leasing Confederation of the CIS, was created after a convention on «interstate» (CIS) leasing was signed in November 1998 by the CIS Council of Heads of State in Moscow. The Council’s Executive Committee created the non-profit and non-governmental Leasing Confederation of the CIS (in cooperation with the united leasing associations of Russia, Ukraine and Belarus) to act as a consultative body. Last month’s conference in Moscow was devoted to ways of integrating «interstate» (CIS) and international leasing with investment processes within the CIS.

*Novosti Russian Information Agency*

November 30, 2000

**FOREIGN PRESS DIGEST**

The Atyrau region of Kazakhstan has come up with an agricultural development plan for the years 2000-02. The program has already brought Atyrau its first new farming equipment in ten years: 14 MTZ-92 tractors on lease from Belarus. The tractors will be distributed among agricultural joint-stock companies and cooperatives. The akim, or governor, of Atyrau, Imangali Tasmagambetov, handed the tractors over to their new owners with full pomp and ceremony. The tractors will be paid off gradually over the course of seven years. 73 million tenge have already been earmarked for equipment purchases next year, which means that dozens more farmers will get new tractors.

*KazAAG Information Agency*

Kazakhstan
October 10, 2000

Belarus now ranks fourth among European nations in terms of international trucking volume (with neighboring Russia in seventh place), announced Belorussian minister of transportation and communication, Aleksandr Lukashov. According to Mr. Lukashov, Belorussian truckers have increased their international freight six-fold over the last five years, reaching a level of approximately 400,000 international trips per year. Belorussian trucking companies currently own about 10,000 trucks that meet Euro-1 and Euro-2 highway standards. All of these trucks were purchased or leased without any financial assistance from the government. Minister Lukashov also pointed out that 94% of the east-bound freight that passes through Belarus ends up in Russia. Most of this freight originates in the Netherlands, Germany, Italy and France.

*ITAR-TASS*

October 27, 2000
Russian airplanes with Canadian engines and American propellers will be manufactured in Uzbekistan, announced the director of the Russian State Civil Aviation Service, Aleksandr Neradko, after negotiations with Uzbek premier U. Sultanov. Russian and Uzbek aviation firms plan to accelerate the serial production of Il-114 aircraft at the plant in Uzbekistan. Uzbekistan Airways has already purchased three of these aircraft, which will enable it to expand its services as early as next year. It also intends to sign a partnership agreement with America’s Delta Airlines and to open regular service between Uzbekistan and Japan next year. The company is currently negotiating a lease agreement with its old supplier from Seattle for two new Boeing 767s.

KYRGYZ-PRESS Information Agency
Kyrgyzstan
October 31, 2000

The government of Moldova has approved a national strategy for reforming the state sector over the next five years. The plan, which is backed by the World Bank, consists of three phases. The first, «Reforming the Central and Local Governments,» contains measures that are designed to create a modern, depoliticized, honest, and financially independent system of administration that would be capable of providing social services. This phase will also include reforms of education and health care. The second phase, «Development of the Private Sector,» will aim to improve and restructure Moldova’s legal system, to reform its state inspectorates, to create infrastructure that will promote business, and to institute a variety of tax benefits for private enterprise. This phase of the program also provides for the creation of business incubators, marketing centers, credit associations, industrial parks, leasing companies, and so on. The third phase, «Optimization of State Expenditures,» will make state spending more efficient by introducing a clear system of ethical standards, as well as a system of penalties for ethical violations. State employees will be required to declare their income, and a new payment system will be introduced to the government sector. The government will also introduce new budget-planning strategies, as well as reforms to social welfare and the judiciary.

Moldpres National Press Agency
November 1, 2000

As of late October, Latvia’s Unilizings had acquired a leasing portfolio of 27.1m lats, according to the company’s financial director, Oskars Latsis. Unileasing’s leasing portfolio had grown by 13.2m lats since the beginning of 2000. Passenger cars make up 44% of the company’s lease agreements; commercial transportation, 18%; and industrial equipment, 25%. As for the company’s lessees, 24% are involved in retail trade, 12% in forestry and wood processing, and 8% in transportation. More and more of the company’s leases are financed in lats rather than euros: 60% of agreements signed in October were in lats, bringing the total for 2000 to 38%, up from 25% at the beginning of the year. Latsis explains the lat’s popularity by the fact that its resource costs are only slightly higher than the euro’s, and without the associated currency risks.

Baltic News Service, Riga
November 9, 2000

A seminar on «The Influence of Leasing and Factoring on Entrepreneurship in Lithuania,» held in the city of Klaipeda, has produced a comparative report on leasing in the Baltics. Lithuanian leasing companies turned in the most modest results, with 600m lits during the first six months of 2000. Latvia was first with 335m lats (2.1 billion lits), followed by Estonia with 7,371 kron (1.6 billion lits). Lithuania’s leasing companies include Hanza lizingas, LZUB lizingas, VB lizingas, LTB lizingas, Parex lizingas and Ukio banko lizingas. According to Rimas Pyatrauskas, the executive director of Lietuvos zemes ukio bankas, there are several reasons for Lithuania’s weaker per-
FLC, an American leasing company, has signed a deal with European aviation consortium Airbus Industrie for 82 airliners. IFLC has ordered sixty-two A320-class medium-range aircraft, with a seating capacity of 124-186, and twenty 250-seater A330-200s. The deal with IFLC has raised the number of orders for European passenger planes to 475. In total, North American airlines and leasing companies have purchased 1,642 aircraft from Europe, 786 of which have already been delivered. The latest deal raises Airbus Industrie’s total sales to 4,060 aircraft, of which approximately 2,500 have already been handed over to the airlines.

Kommersant
November 23, 2000

Italy is preparing to invest in a major new leasing company in Georgia. This decision came after a meeting in Tbilisi between the Georgian minister of economics, industry and trade, Vano Chkhartishvili, and representatives of the Italian ministry of foreign trade and the Italian finance company Finest, which specialized in investment projects in Eastern Europe. Chkhartishvili informed his Italian guests that the Georgian parliament has already drafted a new bill on leasing. The meeting also revealed that the well-known Italian leasing company Locat Spa, whose total assets exceed $1.5 billion, intends to create a leasing company in Georgia, but only if it is granted a controlling block of shares (51%). Finest, which was founded by the Italian ministry of foreign trade, announced that it would help finance the formation of a Georgian leasing company over the next eight years. In return, the Italians have demanded a 25% share of the Georgian company’s capital. Italy’s state-owned Sace will insure the Georgian leasing company against political risks.

Prime News
November 23, 2000

Press digest prepared by Viktoria Struts

QUESTIONS & ANSWERS

How does one arrive at the leasing cost of a motor vehicle?

We presume that «leasing cost» refers to the total value of the lease agreement or to the sum of the lease payments. We might reformulate the question as follows: How does one calculate the total lease payments for a motor vehicle?

A leasing company’s basic goal in calculating the lease payments is to cover all expenses that it will incur under the lease and earn a commission. Therefore, the lease payments usually include all expenses that the leasing company has already borne plus the ones it expects to incur in future. The main components of the lease payments are as follows:

• reimbursement for the cost of the leased property
• interest on loans
• vehicle registration costs (if the vehicle is registered in the lessor’s name)
• customs duties (if the vehicle is imported)
• the vehicle acquisition tax
• insurance payments (if borne by the lessor)
• reimbursement for property tax (if the vehicle is recorded on the lessor’s balance sheet)
• reimbursement for turnover tax, which the lessor must pay on the full sum of the lease payments
• any other expenses incurred by the lessor (see Article 27, Clause 2 of the Law on Leasing, which gives a very detailed list of the lessor’s possible expenses).

The lessee can sometimes save money by covering certain expenses himself, rather than paying for them through the lease payments. Both the size of the lease payments and certain taxes can change dramatically depending on which party covers certain expenses. Insurance is a case in point. When the lessor makes the insurance payments, he naturally tries to recover his costs through the lease payments. By raising the lease payments, he consequently raises turnover tax and VAT. But when the lessee himself insures the leased asset, he lowers the sum of the lease by the sum of the insurance payments. However, it should be remembered that, according to the Statute on the Composition of Expenses, total deductions for voluntary insurance of motor vehicles may not exceed 2% of sales.¹

In addition to using accelerated depreciation, do leasing companies also have the right to deduct an additional 35% in depreciation allowances from the value of a leased asset during the first year of its use, as stipulated under the Law on Leasing?

Article 36 of the Law on Leasing, on «Measures for State Support of Leasing Organizations,» does indeed give leasing companies the right to deduct 35% in depreciation allowances from the original book value of a fixed asset in its first year of use, in addition to applying accelerated depreciation, provided that the asset’s useful service life exceeds three years. But the same article of the Law also stipulates that all of the measures of state support listed therein must either be written into the laws of the Russian Federation and the statutes of the Russian government, or into the statutes of the regional governments (within the scope of their authority).

In our opinion, the regions’ right to offer this tax benefit is dubious at best, since it directly lowers the federal profit tax. Regional governments may only provide tax benefits or exemptions from regional taxes.¹

Thus, the 35% depreciation allowance cannot be considered legal unless appropriate changes are made to the laws on profit tax.

¹ Clause 2.r. of the Statute on the Composition of Expenditures for the Production or Sale of Goods, Labor or Services, the Inclusion of Such Expenditures in the Cost of Production, and on Methods of Calculating Fiscal Results for the Purposes of Profit Tax, ratified under RF Government Order #552 of August 5, 1992.

¹ Article 8, Clause 2 of Federal Law #118—FZ on Implementation of Part Two of the RF Tax Code and on Amendments to Certain Tax Regulations of the Russian Federation (August 5, 2000); and Article 6, Clause 9 of Law #2116—1 on Profit Tax on Enterprises and Organizations (December 27, 1991).
A leased asset is recorded on the lessee’s balance sheet. The lessee had made all of the lease payments. The lease expires before the equipment has depreciated fully. How should the lessee record the completed transaction in his books?

Russian accounting and tax laws are quite clear on this matter. Once all of the lease payments have been completed, the lessee makes an internal record under accounts 01 «Fixed Assets» and 02 «Depreciation of Fixed Assets», indicating that the figures in the subaccount for property leased have been transferred to the subaccount for own fixed assets.

We should add that, upon expiration of the lease, the lessee (now owner) may continue to claim depreciation allowances on the asset, but he may no longer use accelerated depreciation. Consequently, his profit tax will go up.

A reasonable solution is often to «drag out» the lease until the property has fully depreciated. The lessee pays off the principal sum of the lease payments during the early stages of the lease, and then pays off the remaining part in small increments until the end of the full depreciation period. This allows the lessee to use accelerated depreciation until both the depreciation period and the lease itself are completed.