

Report

Leasing in Indonesia

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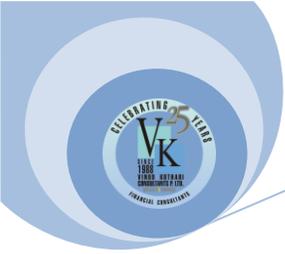
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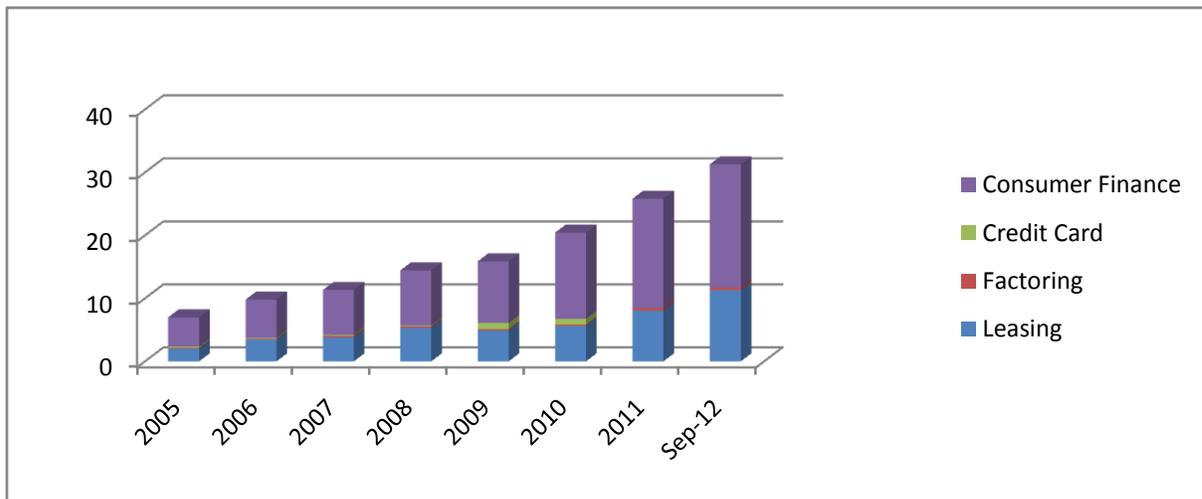
This write up is intended to initiate academic debate on a pertinent question. It is not intended to be a professional advice and should not be relied upon for real life facts.



Introduction

Asset finance business in Asia-pacific in general has been on an upbeat with China being the centre of growth and Indonesia, Korea etc aiding the growth. One of the factors catalyzing the leasing industry in Indonesia is that the economy in general is growing at the rate of 6.5%; two, Indonesia is attracting strong foreign direct investment and three, there is high demand in transportation and infrastructural development. Indonesia has reported foreign direct investment of Rp 221 trillion during 2012 which is 26.07% up from previous year of IDR 175.3 trillion. The car market in general and the commercial vehicle segment in particular is poised for growth and is estimated to grow at 10% annually. The construction equipment segment is estimated to grow at the rate of 5% annually. This report tries to give an insight into leasing business in Indonesia in general and the legal, accounting and taxation aspects pertaining to leasing.

Leasing has been the main growth driver of the multi-finance companies in Indonesia¹. These companies offer a variety of financial products including factoring, financial lease and operating lease, with the latter having either very small residual positions and not offered by many companies unless vendor owned. Finance Leasing is becoming the first choice for both major corporations and small enterprises. Leasing in Indonesia has been consistently picking up. The leasing association of Indonesia *Asosiasi Perusahaan Pembiayaan Indonesia*, provides some data of leasing volumes over the years and is as below:



Source: <http://www.afsaworld.org/reports-regulations/country-reports/indonesia.aspx>

Regulatory aspects of Leasing

Leasing in Indonesia originated in the year 1974 through a Joint Decree between the Minister of Finance, Industry and Trade and Cooperation on “*License for Leasing Companies*”. Leasing was defined in the Decree as –

¹ There are 196 multi-finance companies in India as on September, 2013



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"Leasing is any financing activity engaged by a company to provide capital goods for a fixed period based on periodic payments, with an option to purchase such capital goods or to extend the leasing term based on the agreed upon residual value."

As mentioned in the definition, the Decree earlier only related to financial leases. Later, to increase the coverage of this decree, the Ministry of Finance expanded the definition of Leasing Activities through Decree no. 1251/KMK.00/1989 dated 18th November, 1989, to include the concept of operating lease within its purview. The definition was amended to say the following --

- (a) a leasing company is a company that provides financing facilities, under finance leases as well as operating leases for capital goods, to be used by the lessee for a fixed period based on periodic payments;
- (b) a finance lease is a leasing activity that gives the lessee an option to buy the object of the lease at the end of the lease term, based on a mutually agreed residual value;
- (c) an operating lease is a leasing activity that gives the lessee no option to buy the object of the lease; and
- (d) a lessee is a person or a company that uses the capital goods which are financed by the lessor.

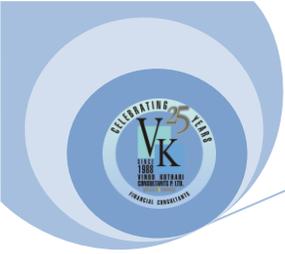
Prior to the Decree, operating leases were done under the garb of rental transactions. With the Decree engulfing operating leases into its ambit, it gave multi-finance companies opportunity to engage in operating leasing business as well.

Under the extant laws in Indonesia a multi-finance companies *i.e.* companies which provide a number of financing activities, require an initial capital investment of Rp 100 billion to commence financing activity in Indonesia of which foreign investors cannot own more than 85% of the capital.

Classification of Leases

In a typical lease transaction, the term of the lease varies from minimum of 2 years to maximum of 7 years in case of property. The duration of the lease is according to the nature of the equipment. Where the lease has an option to buy, the lease is classified as a financial lease, where the option to buy is not provided for, the lease is classified as an operating lease. Another typical feature in Indonesian leasing is that the security deposit (typically 20% of the asset cost) is knocked against the residual value in the asset.

The regulatory classification of leases is financial lease and operation lease.



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Finance Lease:

In a financial lease, the lessor procures the capital goods on the behest of the lessee. The lessee during the term of the lease, as typical in financial leases, pays periodical rentals to the lessor covering the acquisition cost of the capital goods procured by the lessor.

Operating Lease:

In case of the operating leases, the Decree clearly provides the intent of the parties. Wherein the lessor has a clear and open residual value risk, has skills to maintain and resell the assets and has expectation of earning profits on sale of the leased asset. Under the Decree, the lease expenses such as insurance, tax and maintenance of the related capital goods are to be borne by the lessor. As also put down in the definition an operating lease transaction does not have an option to purchase the asset end of the term.

The operating lease definition under the Decree makes a departure from the international norms on operating leases, whereby in operating lease as well, there may be an option to purchase, which is not nominal.

Sales-type Lease:

The Decree provides for a 3rd type of lease, wherein the manufacturer acts as the lessor as well for boasting the sales of its product. Internationally, these type of leases are prevalent as well.

Leveraged Lease:

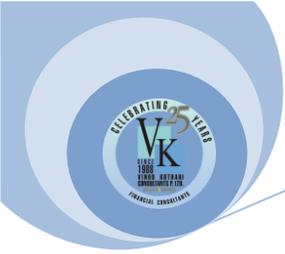
Leveraged leases are those leases wherein the lessor is only acting as the face of the transaction; someone who lends the name. The real financier is a third party. This type of lease is also prevalent internationally.

Syndicated Leases:

As the name suggests, several leasing companies will enter into lease with a lessee.

The regulation also makes classification of leases based on practice and includes:

- a. Direct Leases – Here the possession of the capital goods moves from to the lessee only when the lessor purchases the assets. This may include all the types of leases mentioned above.
- b. Sale and lease back – Here, the lessee sells the capital goods that he owns to the leasing company and takes it back on lease.



Accounting aspects of leasing

As is the generic principle for accounting elsewhere in the world, the Indonesian Accounting Standard also looks at the economic substance of the transaction and the ownership of the capital goods in case of leases is determined on the transfer of risks and rewards in the transaction.

Under the Indonesian Accounting Standard (Statement of Financial Accounting Standard (SFAS) No. 30²), the types of leases have been explained in detail and their accounting in the books of the lessor and the lessee is provided for in the following manner:

Financial Leases:

Financial lease is typically called capital lease in the books of the lessee and the finance lease in the books of the lessor. The three conditions specified in the accounting standard for a lease to be classified as a lease are as below:

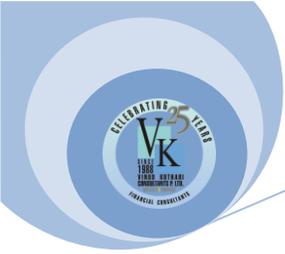
- a. End of term option to purchase the asset by the lessee at a pre-determined price at the inception of the lease
- b. Sum of periodic rentals and option price to cover the acquisition cost of the asset
- c. A minimum lease period of 2 years.

However, if any of the three conditions is not satisfied the lease would be recorded as an operating lease. Hence, if the lease is for 3 years instead, yet be a full pay-out lease, the lease would classify as an operating lease?

Accountant treatment by the lessor:

- The net investment in the leased assets should be shown and recorded as “Net Investment in Finance Lease”. This net investment is arrived at in the following manner: [Lease Payments + Residual Value – (Unearned Lease Income + Security Deposit)].
- The Unearned Lease Income is calculated in the following manner : [(Lease Payments + Residual Value) – acquisition price of the leased asset].
- Where the Lessor sells the asset before the end of the lease period, the gain or loss arising out of it, calculated as the difference between the selling price and the net investment in the leased assets at the time of sale, has to be recorded in the current year.
- Any other income arising out of a lease transaction should be recorded in the income of the current year.

² http://www.russellbedford.co.id/downloads/resources/8dcbb_PSAK-30.pdf



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Accounting treatment in the books of the lessee:

- Lease transactions are treated and recorded as fixed assets at lease obligation. The lease obligation refers to the present value of all the lease rentals and the residual value at the end of the lease period. When the lease rentals are paid, they are allocated as repayment of lease obligation and interest expense (on the basis of the interest rate applied on the lease obligation).
- The present value of the lease rentals should be done as per the discounting rate which is equal to the interest rate charged by the lessor or the rate of interest prevailing in the market at the time of the inception of the lease.
- The lessee should amortize the asset on the basis of the estimated effective life of the asset.
- If the asset is purchased before the end of the lease period, then the difference between the amount paid and the carrying cost of the lease transaction should be adjusted with the current year's income.
- Leases should be presented as Current and Long term liabilities in accordance with the practice followed by the lessee.

Operating Lease:

Accounting treatment by the lessor:

- The capital goods leased out should be recorded as "Leased Asset" in the books of the lessor at its cost of acquisition.
- The lease rentals for the current year should be shown as the "Lease Income". This is to be maintained on straight line basis over the period of lease even if the amount differs in each year.
- The lessor has to provide depreciation on the basis of the estimated effective life of the asset.
- If the lessor sells off the asset before the expiry of the lease period, then the gain or loss arising out of it, calculated as the difference between the book value and selling price should be recorded in the current year of sale.

Accounting treatment in the books of the lessee:

The lease rentals are to be recorded as "Lease Expense" in the current year of payment. The lease rentals will have to be recorded on straight line basis, even if the amount differs in each year.

Taxation of Leases

Under the Indonesian Tax laws, VAT is applicable on importers, manufacturers, wholesalers and retailers and on the provisions of most services at the rate of 10% (other



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than used cars and cigarettes)³. The tax guide also provides that services in relation to banking, insurance, non-banking financial leasing and finance leasing shall be excluded from VAT.

With regard to depreciation of fixed assets, the fixed assets have been categorized as building and non-building for depreciation rates to be applicable. The rate of depreciation varies with the beneficial life of the asset. The useful life and rates of depreciation of tangible assets have been shown in the following table:

Group of Tangible Assets	Useful Life	Tariffs of Depreciation	
		Straight Line Method	Double Declining Method
I. Non Building			
Group 1	4 years	25%	50%
Group 2	8 years	12.5%	25%
Group 3	16 years	6.25%	12.5%
Group 4	20 years	5%	10%
II. Building			
Permanent	20 years	5%	
Non Permanent	10 years	10%	

Source: Indonesian Tax Guide (Deloitte)⁴

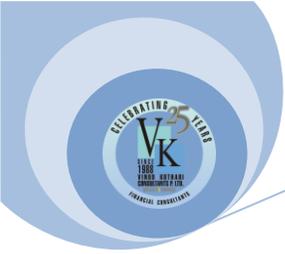
With regard to withholding tax, it is applicable on the any taxable transaction (includes dividend, interest, royalty, prize and awards) at the rate of 15% when payable to residents and at the rate of 20% when payable to non-residents. In case the income is rental income other than income related to use of property other than land/ space rental withholding tax rate applicable to residents is reduced to 2%.

Financial Lease:

The rentals paid by the lessee to the lessor shall be expensed by the lessee throughout the lease period. In case of financial lease, the lessee has an option to buy the asset, once that option is exercised, the lessee will be able to claim depreciation on the capital asset on its residual value.

³ <http://www.claytonmckerverve.com/attach/worldwide-tax-guide-indonesia.pdf>

⁴ <https://www.deloitte.com/assets/Dcom-Indonesia/Local%20Assets/Documents/Indonesian%20Tax%20Guide%202012.pdf>



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The lessor cannot claim depreciation on the capital goods. He can however do a non-taxable provision (for bad debts) equal to a maximum of 2.5% of receivables. In case this provision is not utilized, the same can be treated as income in the year of its realization. In the instance the provision proves insufficient to meet the losses, the same can be deducted from the gross revenue.

Operating lease:

For the lessor, the total of rentals is taxable and the depreciation will be expensed in its balance sheet. For the lessee, the rentals paid are deductible but submitted for VAT purposes.

In a sale and lease-back, the VAT is applied twice; once on the sale leg and the other on the lease leg.

Foreign Direct Investment in Indonesia

The foreign investment in Indonesia is regulated by the BKPM, Indonesian Investment Coordinating Board. The foreign investment is governed by two presidential decrees - Presidential Regulation 76/2007 and Presidential Regulation 36/2010. The first one deals with **“The criteria and establishment of closed business line and open business with conditions in respect of capital investment”** whereas the latter one specifies the **“List of business fields closed to investment and business fields open, with conditions, to investment”**.

The Presidential Regulation 36/2010⁵ provides for a maximum of 85% of foreign capital ownership in cases of companies in Indonesia carrying on the business of leasing. However, in case of aircraft leasing maximum foreign owned capital is 49%.

Conclusion

While Indonesian market has huge potential being a fast growing developing nation, there are bottlenecks at the macro-level in terms of regulatory uncertainty, poor existing infrastructure, corruption etc. With a strong potential for leasing financing in Indonesia and few players to meet the demand, leasing is already on its growth trajectory.

⁵ http://www.bkpm.go.id/file_uploaded/PPres-36-2010.pdf