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VINOD KOTHARI CONSULTANTS PVT LTD

Note on Leasing in China

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In the year 2010, the leasing industry all over the world experienced a downfall. As per the White Clarke Leasing Report (http://www.whiteclarkegroup.com/White-Paper_Leasing-in-China_V-final.pdf), 84% of the countries reported negative growth along with 24% decline in the new business volumes. Ten of the 50 countries experienced more than 50% drop in new business being closed. Under such persistent imbalances, the leasing industry in China reported an incredible progress with an increase in its new business volume by 87%.

HISTORY OF LEASING IN CHINA

Leasing industry was initiated in China in 1981 with the formation of China Orient Leasing Company Limited, the first joint venture leasing company in the country.

- 1990s: Leasing Sector came to a standstill.
- 2001: China became the world's sixth largest trading nation. It entered into the WTO.
- 2003: This Property Leasing Agreement (the "Agreement") is entered into on September 30, 2003 in Beijing, People's Republic of China (PRC) by and between the following two parties China Life Insurance (Group) Legal and China Life Insurance Company Limited.
- 2005: Market was opened by Ministry of Commerce to leasing operation wholly owned by foreign investors. Finance companies being allowed to be engaged in foreign companies. The annual leasing volume was [\\$4.25 bn](#).
- 2006: Finance companies were allowed to be engaged in vehicle leasing. Volvo Financial Service Company was the first to be licensed in August. The annual leasing volume increased to [\\$5.35 bn](#).
- 2007: China Banking Regulatory Commission (CBRC) issued Measures for the Administration of Finance Leasing Companies, allowing Chinese commercial banks to set up financial leasing companies.
- 2008: The annual leasing volume increased to [\\$21.88 bn](#) as compared to [\\$5.87 bn](#) in 2007
- 2009: In the growing executive aviation market, Minsheng Financial leasing launched executive jets leasing services. The annual leasing volume was [\\$41.01 bn](#).
- 2010: 17 financial leasing companies supervised by CBRC achieved 50% of the new business valued [RMB 350 bn](#).

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LEASING MARKET IN CHINA

Types of Leases

The two types of leasing in China are finance leasing and normal leasing. Finance Lease is a financial agreement under which an asset is purchased by the lessor from the supplier at the determination of the lessee and provides the use of this asset to the lessee against payment of a leasing fee. It is the most common type of contract under which the lessor transfers essentially all risks and rewards connected to the ownership of the asset to the lessee. There is a substantial cost difference between the financial and normal lease.

Types of Lessors

Bank lessors: They play a dominant role in the market and focus on big ticket asset such as aircraft and transaction worth being \$15 million.

Non-banking Lessors: They work on large margins and are first to suffer when the credit becomes scarce.

Types of Leased Assets

The leasing company can enter into the leasing transaction involving movable assets, while dealing with real estate cannot be an object of the leasing company. Intangible assets (especially software) cannot be subject to lease transactions. If the intangible asset forms a part of tangible, constituting not more than 50% of the value of the asset, it can be subjected to lease transaction.

Current market status

In recent years, the Chinese market place has enjoyed significant liberation. Bank lessors have become the leading players with captive lessor and third party lessor being second and third. The striking market developments are as follows:

- Increased demand for off-balance-sheet finance.
- Regulatory bodies taking positive initiatives to make leasing more accessible to SME's.
- Growth in captive and independent lessor sectors.

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- There are roughly 181 leasing companies registered in China at the end of 2010, gaining 64 new leasing companies compared to 117 in 2009.
- Total leasing funds/revenue increasing from 86-fold RMB 8bn to RMB 700bn.
- By 2010, the penetration was 3.1% representing huge growth potential.
- Lease financing is almost exclusively dedicated to the low margin big ticket sector.
- The annual leasing volume as a percentage of Gross Domestic Product is 0.82.
- The Chinese leasing market gained an 86.7% increase during the 11th Five Year Plan and 89% in 2010. This moves China from the previous year's eighth position to the world's top four performers.
- There are about 170 leasing enterprises in China.
- Currently prominent players in the market are Siemens, GE Capital, China Huarong Financial Leasing Co. Ltd., a subsidiary of China Huarong Asset Management Corp, ICBC Financial Leasing Co. Ltd etc.
<http://en.21cbh.com/HTML/2011-1-14/1398.HK-Leasing.html>

LEASING REGULATORY BODY IN CHINA

The China's leading sector is licensed regulated and administered by three Government departments.

- [MINISTRY OF COMMERCE \(MOFCOM\)](#) –There are around 50 Sino-foreign venture and a few solely foreign funded leasing companies which are licensed and regulated by MOFCOM. They are not financial institutions and do not participate in inter-bank lending or offer of financing products. As per its regulation issued in 2005, both leasing and rental companies were allowed to be established and licensed with 100% foreign shareholding.
- [CHINA BANK REGULATORY COMMISSION \(CBRC\)](#) - There are 17 financial leasing companies supervised by CBRC. In 2007, CBRC issued new administrative measures for financial leasing companies, allowing commercial banks to set up financial leasing companies. It supervises leasing companies invested by domestic Chinese investors and auto finance companies with both foreign and domestic investors. Both these companies can participate in inter-banking lending.

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LEASING ASSOCIATIONS

There is an association called China Leasing Industry Forum. Other leasing associations are the Leasing Business Committee of China Association of Enterprises with Foreign Investment and the Financial Leasing Professional Committee.

Local associations are as follows:

- [Hong Kong Equipments Leasing Association](#)
- Beijing Leasing and Rental Association
- Shanghai Leasing and Rental Association
- Zhejiang Leasing and Rental Association
- Tianjin Leasing and Rental Association

LEGAL FRAMEWORK

Regulations for leasing businesses and leasing transactions in the People's Republic of China (PRC) cover three main areas:

- The regulation of leasing contracts by the PRC Contract Law, with separate chapters on both rental contracts and finance lease contracts;
- The regulation of different kinds of leasing companies, their establishment, supervision and risk control. A CBRC Leasing Company must put in place a management system to regulate affiliated transactions. Also the total financing provided by a CBRC Leasing Company to a single lessee or affiliate must not exceed 30% of its net capital and its total financing to all its affiliates must not exceed 50% of its net capital. For approval of establishment applicant needs to obtain the CBRC's approval to establish the CBRC Leasing Company at the same time CBRC must approve its commencement of business. For more details:- <http://www.allenoverly.com/AOWEB/Knowledge/Editorial.aspx?contentTypeID=1&contentSubTypeID=7944&itemID=46125&prefLangID=18452>
- Regulation of accounting and taxation of rental and finance lease transactions: Accounting of leasing transactions is conducted in accordance with the Chinese "Enterprise Accounting Standard No. 21 –Lease", which is primarily based on [IAS 17](#). For tax purposes, the main difference between a finance and operating lease lies in the tax base for calculating the 5% business tax.

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TAXATION ASPECTS

The PRC Corporate Income Tax (CIT) law has become effective in China from 1st January 2008 under which the taxpayer is classified into Tax Resident Enterprises (TREs) and non-TREs. Hence the treatment of operating and financial lease differs depending upon the taxpayer. Income derived from operating and financial lease by either TRE or non-TRE in China is subject to Business Tax (BT) at 5%. In case the lessee leases equipment from outside China, import duty and import VAT on the equipment leased is applicable.

Tax treatment of financial lease

- In case of TRE, the lessor is disallowed recognizing the leased assets as its fixed assets whereas the lessee is allowed to. The lessee should recognize the unrealized financial expense at the beginning of the lease agreement and allocate it over the lease term. For the lessee the finance expense and depreciation is generally tax deductible while lease payments are not.
- In case of non TRE, if income derived by the lessor relates to its personal establishment (PE) in China, the tax treatment would be the same as that of the resident lessor under finance lease and if the income derived by the lessor does not relate to its PE in China, it will be subject to 10% Withholding Income tax (WIT).
- The stamp duty applicable is 0.05% gross leasing fees.

Tax treatment of operating lease

- In case the taxpayer is a TRE, the lessor will recognize the rental income in its income statement which would form a part of its taxable income and subject to income tax @ 25%. It shall recognize the leased asset as fixed asset and the depreciation thereon would be tax deductible. The payments made by the lessee are tax deductible
- In case of a non-TRE, if income derived by the lessor relates to its PE in China, the income will form part of the PE's taxable income and subject to income tax at 25%. If income derived by the lessor does not relate to its PE in China, withholding income tax ("WIT") at 10% will be imposed on the gross income subject to treaty relief
- The stamp duty applicable is 0.1% gross leasing fees