

# Understanding Asset Leasing Solution

## Part-1



## Overview

Enterprises need essential equipment like plant and machinery, fleets, medical devices for their daily operations which they can either buy or lease. Buying such equipment can involve significant upfront cost which can be challenging specifically for small and medium enterprises. This is where leasing comes in offering flexibility, cash flow management, and various other benefits to the businesses. The players in the leasing market include Non-banking Finance Companies (NBFCs) and Non-banking non-finance companies (NBNCs), which include equipment leasing operators, rental operators, and asset life cycle companies.

## What is Asset Leasing?

Asset leasing is a contractual agreement in which the owner of an asset or an equipment allows another entity the right to use the asset for a specific period in exchange for periodic rent payments. The lessor retains the ownership of the asset, while lessee has the rights for the economic use of the asset without the burden of ownership. At the end of the lease tenure, the lessee can choose to renew the lease agreement, return the asset, or purchase the asset.

## Elements of Leasing

- **Lessor:** The owner of the asset and in most cases the financier of the asset.
- **Lessee:** The receiver/user of the asset under the lease agreement. Lessee makes rental payments to lessor for using the asset.
- **Sub – lessee:** In special circumstances, the lessee can also sub-let the asset to a sub-lessee depending on the contractual agreement.
- **Financer:** In certain lease contracts, there would be a third party financier that provides the lessor with the capital to purchase the asset and lease it to the lessee.
- **Leased Asset:** The asset that would be leased as per the lease financing contract.
- **Lease Contract:** A legally binding agreement specifying the details, the obligations and responsibilities of the lessor and the lessee for using the asset.
- **Lease Rentals:** The consideration paid by the lessee for using the asset.

## Leasing Landscape in India

The origin of the leasing industry in India can be traced back to 1970s with the establishment of 'The Leasing Company of India' in 1973, which remained the only leasing company in the country for 7 years. The leasing industry entered the growth phase in early 1980s with few organisations

joining the business for taking tax advantage followed by numerous financial institutions and banks (including ICICI) announced their plans for leasing.

RBI considered leasing as a non-banking activity and asset backed lending was among the array of other financial products offered by non-banking financial companies (NBFCs). However, in 1994, RBI allowed banks to directly enter the leasing market after drawing similarity between financial leasing and traditional lending. With the growth in the sector, different leasing players based on the business activity became part of the leasing market in India including specialized leasing companies, banks and their subsidiaries, NBFCs and NBNCs.

NBFCs offer all kinds of asset-backed lending products including both financial and operating leases. Most NBFCs also offer leasing in more than one asset class.

Leasing services are beneficial for enterprises such as mid-market enterprises (MMEs) that may not have the financial resources to purchase the asset upfront. By providing these services, NBFCs can enhance the operational efficiency of the businesses.

## Advantages of Asset Leasing



**Capital management:** Leasing allows enterprises to use the asset without bearing the upfront costs to purchase it. This enables companies to preserve their capital and redirect it towards alternative uses such as expanding operations or paying off existing debt and unforeseen expenses.



**Staying up to date with technology:** With lease financing, enterprises can easily upgrade to new models without being tied to outdated asset enabling businesses to stay up to date with the evolving technology.



**Working capital efficiency:** By eliminating large initial payments to buy the asset, enterprises can efficiently manage their cash flow and working capital requirements thereby driving operational efficiency.



**Tax benefit:** Lease rental expenses are accounted for as expense (i.e. both principal and interest portions of the lease expense are tax deductible).

## Regulatory Aspects on Leasing

In India, asset leasing is regulated by the Reserve Bank of India (RBI) and the Companies Act, 2013. RBI has set guidelines for financial leasing companies and NBFCs for conducting leasing activities.

As per RBI regulations, a company engaging in financing must have a certificate of registration categorizing it as a financial services provider. Under the National Industrial Classification Code4, financial leases are classified as financial transactions under financial services activities while operating leases are considered as rental contracts.



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