Leasing financing in Germany

Over the last four decades, leasing has become a permanent feature of corporate financing in Germany. Today, almost one-fifth of fixed investment in the business sector is financed through leasing, the main focus being on motor vehicles. This special form of external financing is an alternative to, and supplements, the bank loan. Leasing enables enterprises to invest in buildings or machinery and equipment without having to use capital or debt. This alleviates the problem that demand for new capital goods may not be met, particularly during an upturn, because enterprises eager to invest experience financing and collateralisation difficulties. Leasing is an attractive financing instrument for lessors because it allows them not only to avoid the usual credit risks but also to pass the property and price risks involved in capital goods on to the lessee. The reasons why the parties opt for leasing are not limited to purely financing and risk aspects, however; they also take organisational and marketing aspects into account.

A special analysis of the annual accounts of leasing firms contained in the Deutsche Bundesbank's database for the last available financial year, 2008, shows these enterprises to have special balance sheet and income statement structures; moreover, they resort to a variety of sources for refinancing. The low level of own funds that is characteristic of the leasing industry heightens risk potential. For example, the crisis-induced disruptions in the financial system led to lasting financing difficulties for some leasing firms. This was compounded at the time by the strong reluctance of enterprises to invest, causing demand for leasing-financed movable property to fall considerably. Moreover, the motor vehicle leasing sector sustained losses due to the heavy decline in used car prices caused by the crisis and the car scrapping premium scheme, as it proved impossible to sell used leased vehicles at the prices with which the buyback had been calculated in the lease contracts.

There are big differences between independent leasing companies, which have to obtain financing from banks and on the capital market, and the majority of manufacturer or bank-dependent enterprises, which can turn, above all, to their parent company or financial services network as their funding source. This means that, for the latter, sufficient finance is available even when risk provisions are small.

The importance of leasing in Germany

Leasing a firmly established financing instrument

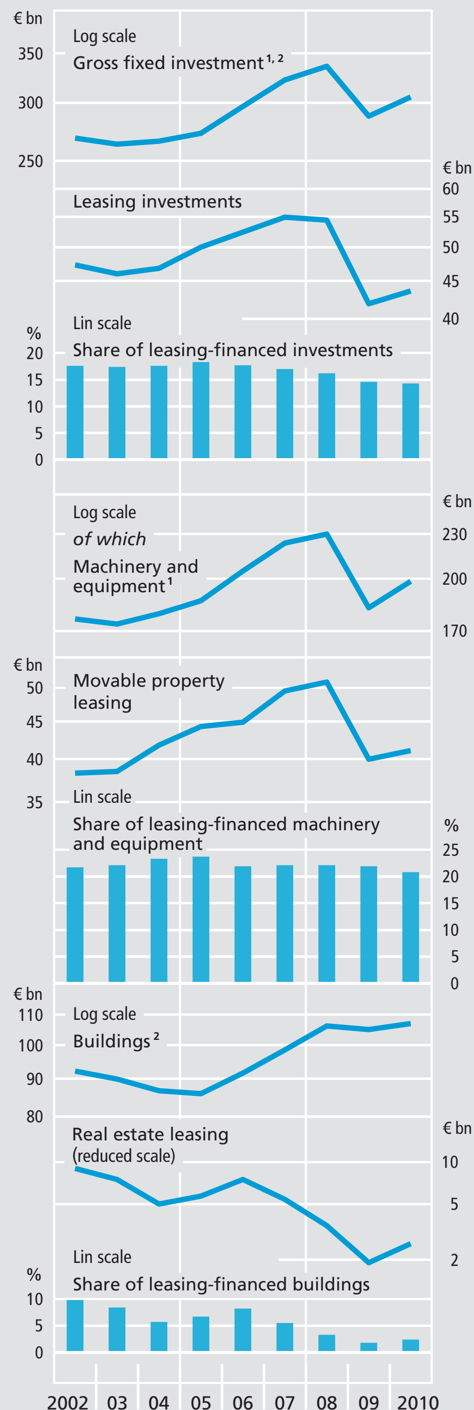
Over many years, leasing has become a major financing instrument for German enterprises. According to the ifo Institute, the overall leasing ratio – ie all leasing-financed investments to overall fixed investment – rose from 2% in 1970 to more than 18% in 2005.[1] Its market share subsequently dropped somewhat, due mainly to the decline in real estate leasing, which decoupled from commercial construction demand. In movable property leasing, when investment in machinery and equipment plummeted in the wake of the financial and economic crisis, the lucrative business years were followed by a drop in new business. As a result, the share of leasing-financed machinery and equipment has changed little in recent years and was just over one-fifth in 2010.

Large share of externally financed investment

Just how important leasing is for the corporate sector is demonstrated by the share of externally financed investment accounted for by leasing, which according to the ifo Institute's estimates has averaged almost 50% in recent years.[2] This shows that for enterprises which cannot or cannot fully realise their investment projects with internal financing, leasing is an important alternative to classic bank borrowing.

1 See A Städtler (2010), Die Investitionswelle erreicht das Leasing. 4% Wachstum 2010 – beste Aussichten für 2011, ifo Schnelldienst, 63(24), p 74 ff.
2 See T Hartmann-Wendels and A Städtler (2010), Kein Wachstum ohne Investitionen – keine Investitionen ohne Leasing, Bundesverband Deutscher Leasing-Unternehmen (Association of German Leasing Companies, BDL), Annual Report 2009/10, p 8.

Leasing-financed investment



Sources: Federal Statistical Office and ifo Institute. — 1 At current prices; including other assets (eg software). — 2 Excluding residential housing construction.

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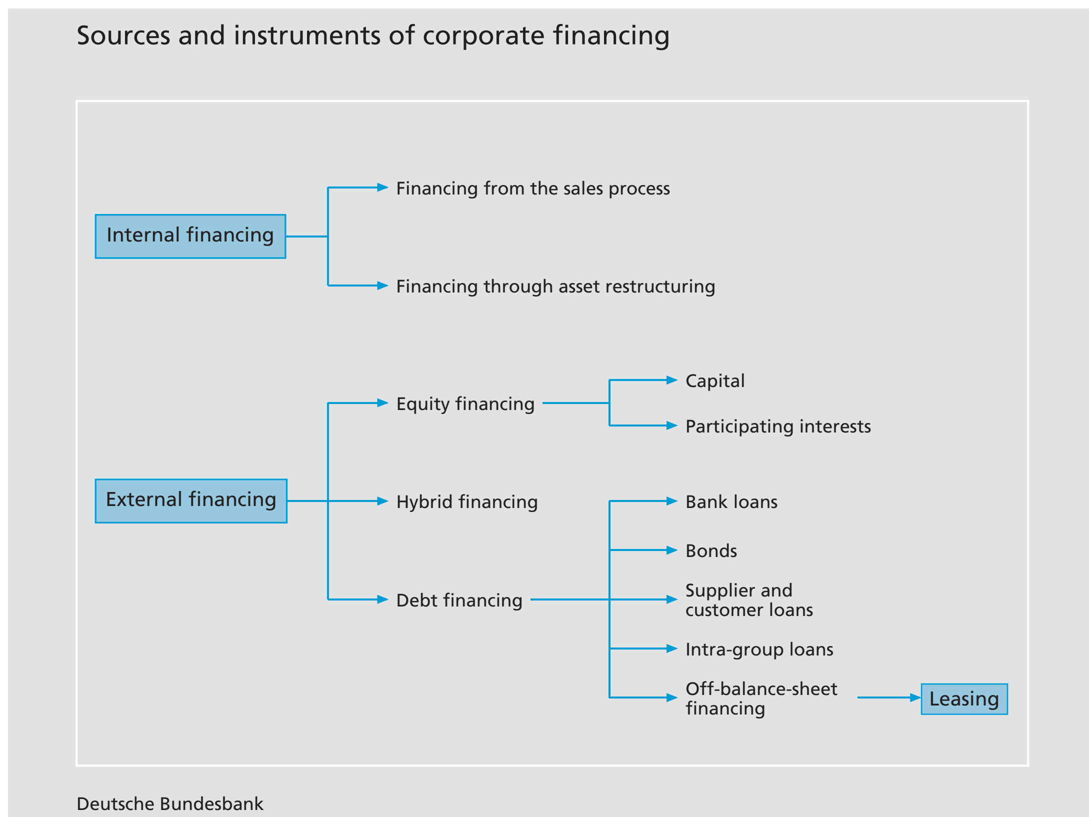
Sources and instruments of corporate financing



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Leasing as financing instrument for enterprises

Leasing's place in enterprises' financing system

When it comes to investment financing, enterprises can make use of a wide range of possibilities. Whereas internal financing refers to those forms of capital procurement which involve enterprises drawing on their own financial strength (for example, retained profits), funds raised via external sources are subsumed under external financing. Depending on the legal position of the entity providing capital, external financing can be divided into equity and debt financing as well as hybrid financial instruments (mezzanine capital), which are a mixed form in terms of liability and rights to participate in business decisions. Debt financing is based on third-party claims in respect of which the enterprise must pay not only a fixed interest rate but also specified redemption amounts. This category includes bank loans, bonds (debt securities), supplier, customer and intra-group loans as well as leasing.

Definition and financial accounting of leasing

To be more precise, leasing denotes a special form of corporate finance whereby a company (lessor) grants the business partner (lessee) the contractually areed right to use for a specified period, in return for payment, movable or immovable capital goods in the form of lease or rent contracts. Instead of a transfer of ownership through purchase, the subject matter of the contract is merely the surrender of use, for which the lessee has to

pay a leasing fee.[3] As long as the lessor remains the beneficial owner, he must carry the leased assets in his balance sheet in accordance with section 246 (1) of the German Commercial Code (*Handelsgesetzbuch*). Commercial law contains no other provisions in this respect. However, the German tax authorities have, with reference to section 39 (1) and (2) of the German Fiscal Code (*Abgabenordnung*), laid down in several decrees[4] what is deemed to be a leased asset that must be reported in the lessor's balance sheet (see the annex on pages 45-47).

Advantages for the lessee

Tax advantages for the lessee

Leasing financing of fixed investment gives rise to at least temporary tax advantages for the lessee compared with the classic bank loan because the complete leasing payments (interest, cost and redemption component) and, above all, the special one-off payments constitute tax-deductible operating expenses. Given the disproportionately high cost component at the start of the contract, these may be considerably greater in the initial phase than the interest and redemption payments for a bank loan of a similar amount and the depreciation values in accordance with the relevant tax guidelines.[5]

Liquidity and equity conserved

A further advantage for the lessee stems from the fact that operational investments in buildings or machinery and equipment can be realised without actually having the necessary funds at the time of investment. Apart from special payments to be made at the start of the contract term, neither debt nor equity need be used – not even in the form of collateral, which ties up own funds. Thus, leasing is a type of financing that conserves both liquidity and equity. This makes it particularly interesting for newly established firms which are usually undercapitalised, have a low operational cash flow and often have to finance high initial investments. Leasing can act as an investment motor inasmuch as the expansion of demand for capital goods is not impeded by financing or collateral problems affecting firms that wish to invest. In addition, avoiding financing restrictions on innovative firms benefits the rapid rollout of new technologies and products, and thus accelerates the technological diffusion process.

Full financing and balance sheet neutrality

Another argument in favour of leasing is that it is usually possible to cover the entire investment amount, whereas full financing is normally not possible with a bank loan (especially in the real estate sector). Given that, under certain conditions, leasing-financed capital

3 According to the regulations applicable in Germany, lease contracts differ from normal rent agreements pursuant to section 535 ff of the German Civil Code (Bürgerliches Gesetzbuch) in that the lessor passes the property and price risk on to the lessee; however, the latter is himself able to choose the object to be "rented". Moreover, lease contracts usually stipulate that the lessee must bear the costs of maintenance and repairs, and is responsible for asserting warranty claims against the manufacturer.
4 The main decrees are the decree on movable property leasing (Mobilienleasingerlass) of 19 April 1971, the decree on real estate leasing (Immobilienleasingerlass) of 21 March 1972, the decree on partial amortisation (Teilamortisationserlass) of 22 December 1975 and the decree on partial amortisation in respect of real estate leasing (Teilamortisationserlass zum Immobilienleasing) of 23 December 1991.
5 A major factor in this connection is that, in early 2010, the section of the business tax reform of 2008 which had provided for a pro rata addition of the financing component of the leasing payment to the assessment basis for taxable profits with regard to the calculation of business tax payable by the lessee (revocation of the banks' privilege in respect of business tax for leasing companies) was revoked if certain conditions were fulfilled.

goods are not reported as assets in the lessee's balance sheet, this type of financing – unlike the other external funds – is not reflected in the balance sheet. This means that, in some cases, the rating as well as the terms and conditions for borrowing funds may remain unaffected.[6]

Pay as you earn principle

Furthermore, leasing means that the asset can be used productively while the rent payments are being made, so that the investment asset finances itself (pay as you earn principle). Additionally, the instalment payments, which are fixed in advance, provide a reliable basis for planning and costing for operational controlling and standard cost accounting purposes. In return for these advantages and the greater flexibility, the lessee accepts that this form of financing is relatively expensive because the payment instalments are higher than the cost for the user if the asset were purchased.

Advantage for the lessor

The usual credit risk is avoided

For the lessor, lease contracts – as compared to other investment forms – offer the advantage that they reduce credit risk. Because the lessor retains ownership of the asset during the term of the contract and transfers only the right of use, he largely avoids the disadvantages of the asymmetric distribution of information that usually exists between creditor and debtor. In the event of the lessee's inability or unwillingness to pay, the creditor has the right to call for the asset to be handed over. Thus, the lessor has a preferential status vis-à-vis the debtor such as also exists with a collateralised loan. This privilege implies that transaction cost such as that incurred by both parties through the provision of collateral under a loan contract do not occur.

Risks passed on to the lessee

A further possibility offered by leasing is that all property and price risks connected to the investment asset can be passed on to the lessee. It is assured, at least with contracts that are in keeping with the relevant decrees,[7] that the lessor's acquisition or production cost, funding and administrative cost as well as the profit mark-up will, as a rule, be reimbursed in full. Where sales proceeds are generated that are less than the object-specific residual amortisation amount (and therefore less than the difference between paid leasing payments and the lessor's total cost), the lessee has to make up the difference.[8] Where sales proceeds are higher, the lessor is entitled to at least part of them. Thus, he does not usually bear any risk of a loss in value but participates in any increase in value. Unlike in the case of rent agreements, maintenance and repairs obligations are likewise usually passed on to the lessee. Yet another typical feature of leasing is that the right to claim warranty against

6 If the reforms proposed by the IASB on lease accounting are pushed through, these advantages will largely become obsolete for IFRS consolidated financial statements. According to the Exposure Draft Leases of 17 August 2010, a distinction is no longer to be made between operating and finance leases. Instead, the lessee has to report an asset in his balance sheet according to the right of use approach. Its value equates to the discounted leasing payments and the initial direct costs pertaining to the transfer of the leased asset.
7 This refers to lease contracts which take the Federal Ministry of Finance's four decrees on leasing into account, and as a result of which the leased assets are reported in the lessor's balance sheet.
8 By contrast, general price risks on the secondary markets, for example as a result of an economic slump, are borne by the lessor in that an adjustment is made to the residual amortisation.

the supplier, which would otherwise rest with the lessor as the buyer of the asset, is transferred to the lessee. By the same token, the transfer to the lessee of most of the cost and risks of course implies that leasing financing is a relatively expensive alternative method of financing for the lessee, who has to pay the lessor for the gains in terms of flexibility and efficiency described above.

Package solutions boost sales

Producers of and dealers in machinery and equipment often use leasing offers to boost sales. One important factor here is the considerable flexibility with which lease contracts can be tailored to the customer's needs. Thus, they may offer package solutions that go well beyond the confines of pure financing. Marketing-oriented concepts of this kind have established themselves, above all, in motor vehicle leasing. The services provided range from simple service lease contracts (covering maintenance and repairs by the lessor) to full service leasing (fleet management) by the leasing companies; the latter takes into account the trend at many industrial enterprises of focusing on core business and outsourcing services.

Diffusion of leasing

Investment categories and …

According to the Association of German Leasing Companies (BDL), in 2010, road vehicles (ie passenger cars and commercial vehicles) accounted for 64% of new leasing business. This was the largest share in movable property leasing and included both corporate and private customers, which probably represent around one-third of the entire vehicle leasing market. The outstanding importance of vehicle leasing also in the commercial sector is partly due to the fact that leasing companies have in recent years added product-related services such as maintenance and repairs to the agreements they offer, making them particularly attractive for businesses. Other important categories in the leasing sector are, as in the past, production machinery (notably construction machinery, industrial trucks and forklifts) with a share of around 12%, office and IT equipment (around 9%), telecommunication engineering and signalling equipment as well as other equipment (just over 7%). Because of tax law changes with regard to the framework conditions for movable property leasing funds (abolition of tax loss allocations in the case, for example, of aircraft and ship leasing funds) and the aviation crisis, the importance of leasing in this category has halved in recent years and currently amounts to a mere 2%.[9]

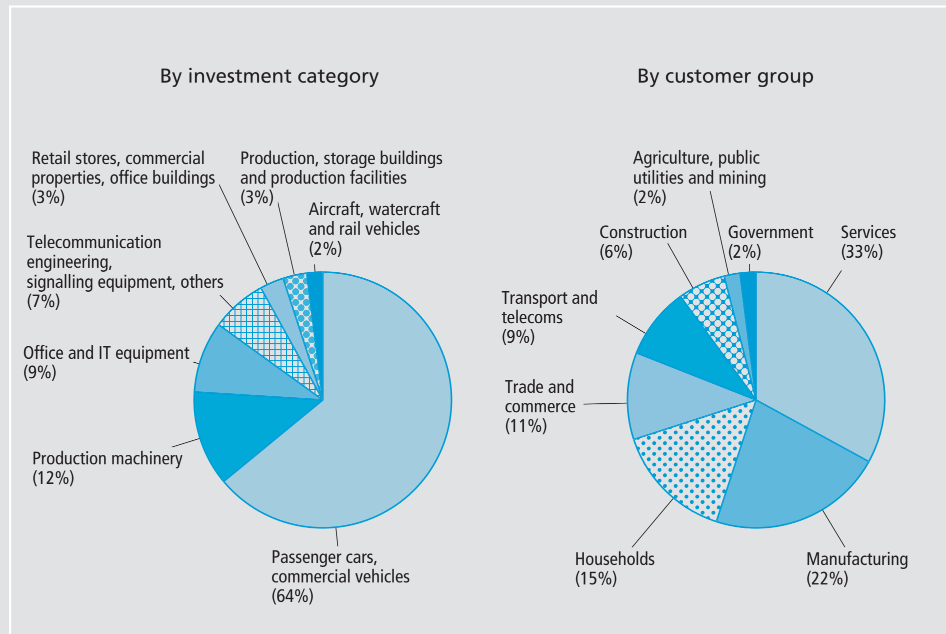
… leasing customer groups

The largest commercial customer group in movable property leasing comes from the services sector (33%) – this is probably due in part to the prominent role played by vehicle leasing in this customer-oriented sector – followed by manufacturing (roughly 22%), trade and commerce (11%) and transport and telecommunication engineering (9%). Leasing customers in construction account for a share of only 6%. In this sector, the orders situation has been affected by considerable uncertainty in recent years, leading to a decline in leasing financing. Instead, construction machinery is obtained from hire-only companies on a

9 See A Städtler (2010), loc cit, p 73.

Shares in new business in movable property leasing

November 2010



Source: Association of German Leasing Companies.

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short-term basis and for the particular order in hand. These firms have recently seen their business volume expand as a result.[10]

Leasing companies' balance sheet and income statement structures

Industry-sector-specific particularities in balance sheet and income statement

Compared with commercial banks' balance sheets, which are characterised by the intermediation process, and non-financial corporations' financing and asset structures, which are driven by the production of goods and services, a special situation exists with regard to the annual accounts in the leasing sector given its business model. The Deutsche Bundesbank's financial statements statistics database contains around 230 financial statements of leasing companies (out of a total of some 2,200 such enterprises in Germany); their balance sheets and income statements were pooled for the analysis described below. The evaluations refer to 2008, the last financial year for which data are almost completely available.[11]

Characteristic of the asset side of these leasing firms' balance sheets is that the vast majority of their assets comprise tangible fixed

10 See Bundesverband der Baumaschinen-, Baugeräte- und Industriemaschinenfirmen e.V. (Federal Association of Construction Equipment and Industrial Machinery) (2009), bbi-Konjunkturbericht, Entwicklung 2009/2010, Händler und Vermieter mobiler Arbeitsmaschinen schliessen 2009 mit Umsatzrückgängen ab, press information 2010.
11 These companies do not include hire companies, pure financial services providers, service companies, real estate or asset management companies, nor leasing companies where leased asset ownership, financing and income are allocated to different companies in that the firm is split into an operating and a holding company (two-tier model).

Aggregate balance sheet and income statement of the leasing companies contained in the Bundesbank database in 2008*

Item	€ billion	%
Balance sheet		Share of balance sheet total
Assets		
Intangible fixed assets	0.13	0.2
Tangible fixed assets	55.97	80.3
Inventories	0.56	0.8
Cash	1.01	1.4
Receivables	10.38	14.9
of which		
Trade receivables	3.86	5.5
Securities	0.17	0.2
Other long-term equity investments	1.21	1.7
Prepaid expenses	0.25	0.4
Capital		
Equity	2.28	3.3
Debt	67.40	96.7
Liabilities	45.80	65.7
of which		
Liabilities to banks	12.38	17.8
Liabilities to affiliated companies	23.07	33.1
Bonds	3.37	4.8
Provisions	1.18	1.7
Deferred income	20.42	29.3
Balance sheet total	69.68	100.0
Income statement		As a percentage of sales
Income		
Sales	31.34	100.0
Interest and similar income	0.56	1.8
Other income	0.91	2.9
Total income	32.81	104.7
Expenses		
Cost of materials	15.19	48.5
Personnel expenses	0.43	1.4
Depreciation	13.30	42.5
of which		
of tangible fixed assets	13.20	42.1
Interest and similar expenses	2.11	6.7
Other expenses	1.66	5.3
Total expenses	32.69	104.3
Annual result before taxes on income	0.12	0.4
Taxes on income	0.05	0.2
Annual result	0.07	0.2

* Based on 228 named leasing firms.

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Asset side characterised by large stock of tangible fixed assets

assets, accounting for just over 80% of the balance sheet total. Thus, this item contains those leased assets which do not appear in the balance sheets of producing enterprises and service providers, yet make a very significant contribution to their value added. With tangible fixed assets of around €56 billion, the enterprises chosen here probably represent at least one-quarter of all leasing-financed machinery and equipment in Germany. According to the ifo Institute, the stock of leasing-financed tangible fixed assets in 2008 totalled around €250 billion. However, it must be borne in mind that the annual accounts analysed here capture only the residual book values in the ifo Investment Survey, which are substantially lower than residual book values.[12] This means that coverage would be considerably greater with a comparable valuation.

Low volume of customer receivables through factoring and ABS

Three-quarters of the remaining (just under) 20% of the assets comprise receivables, although such claims on lessees (trade receivables) only account for just over 5% of the balance sheet total. This share is less than half of the value reported by non-financial corporations as a whole. Among other things, the low share of customer receivables is a result of leasing companies' special refinancing structures. This is because, in addition to manufacturer and bank-dependent leasing companies, there exists a group of economically and financially independent companies which procure part of the funds they need by selling current and future customer receiva-

12 See A Städtler and J Gürtler (2009), Einbrechende Investitionen und der Gesetzgeber bremsen das Leasing, 23% weniger Neugeschäft 2009, ifo Schnelldienst, 62(24), p 4.

bles via asset-backed securities (ie by originating and distributing different claims) and factoring (selling current receivables). Moreover, these companies use the sale of future customer receivables (forfaiting) to refinance their operations.

Liability side shows low equity, high bank and intra-group liabilities

The liability side, too, clearly reflects how these two groups of leasing companies differ with regard to financing. In the vast majority of cases, firms in which banks or industrial enterprises hold a major share receive intra-group funding. Thus, intra-group liabilities are, on the whole, leasing companies' most important funding source, accounting for one-third of the balance sheet total. This no doubt partly explains why leasing companies have an especially low capital ratio compared with other business sectors of just above 3%. Manufacturer and bank-dependent leasing firms can afford such low risk provisioning only because they have, within the group to which they belong, refinancing partners that provide them with the funds they need.[13] By contrast, for independent leasing firms, which are mainly small and medium-sized enterprises, bank liabilities are an important financing source, totalling just over €12 billion or around 18% of the aggregate balance sheet total.

Low capital ratio heightens insolvency risk

Insolvency statistics show that – except where bank or manufacturer-dependent companies are concerned – this low capital ratio entails risk potential. For instance, the number of insolvency proceedings in the renting of machinery and equipment sector, which also includes leasing firms, rose again in 2010 (2%), whereas manufacturing saw a decline of 16% during the same period. In the last two years, which have been shaped by the financial and economic crisis, a large number of SME leasing companies have exited the market according, also, to the ifo Institute.[14] Not only were they beset by crisis-induced financing problems and lost revenue from leasing operations: they also suffered heavy declines in sales and prices in the secondary market for used and returned leased assets (such as motor cars), which had not been anticipated when the contracts were drawn up.

Large leasing firms also refinance themselves on the capital market

By contrast, larger leasing companies also have the option of procuring the necessary finance on the capital market. In 2008, despite financial market tensions, they issued bonds in relatively large amounts. In the case of the leasing companies under consideration here, bonds accounted for around €3.5 billion or no less than 5% of all funds raised.

Large volume of deferred income

Also typical of leasing is the large volume of deferred income, which constitutes a sizeable liability item and accounts for just over €20 billion or slightly more than 29% of the balance sheet total. This involves, on the one hand, counterpart entries against inflows

13 The BDL points out that the capital ratios of leasing firms are systematically distorted down. Given the divergence between lease contracts' durations and tax depreciation times, and because the sales revenue is taken into consideration upon termination of the contract, asynchronous developments of expenditure and income arise in the leasing companies' single-entity accounts that are drafted in accordance with the German Commercial Code (*Handelsgesetzbuch*) due to the periodisation requirement and the completed-contract method. See Bundesverband Deutscher Leasing-Unternehmen (2003), Substanzwertrechnung für Mobilien-Leasing-Unternehmen, Berlin. However, this problem does not arise solely in the case of leasing companies, but leads to corresponding distortions in the balance sheet and income statement of all enterprises with long-term production.
14 See A Städtler (2010), loc sit, p 70.

stemming from the forfaiting of future leasing receivables. Because, in this connection, income is received which will not arise until the future, deferred income has to be stated on the liability side in the amount of the present value of the sold receivable, and will then be gradually written back over the term of the lease contract. Moreover, special payments made by the lessees (in particular, advance rent payments as well as implementation costs) have to be allocated on an accrual basis of accounting and included in deferred income. For the lessee, this constitutes expenditure which is tax-deductible in its entirety provided the contracting parties can present economic reasons for these one-off payments. This is why, in practice, there is such great interest in agreeing high one-off payments and helps explain the unusually high amount of deferred income in the aggregate balance sheets of the leasing companies considered here.

Large volume of depreciation and interest expenditure in income statement …

Leasing companies' income statements likewise contain a number of special features. For instance, the result of leasing firms is shaped, above all, by the cost of materials (€15 billion or 48% of sales), which represents the cost of acquiring the leased assets. Especially typical, however, is the substantial volume of depreciation on tangible fixed assets and relatively high financing cost with comparatively low personnel cost. It has to be borne in mind here that depreciation, which amounts to around €13 billion (representing over 40% of sales) and is therefore almost equal to the cost of materials, often exceeds the agreed leasing payments, particularly in the initial phase of contracts. Since declining-balance depreciation was abolished under the Annual Tax Act 2008 (*Jahressteuergesetz 2008*), this is primarily due to the tax deductibility of excessive first rents as well as of installation or implementation cost, which according to regulations issued by the German tax authorities must be reported as assets and depreciated within five years. In some cases, this leads to losses which are only recouped over the entire term of the lease contract. It is probably also because new business volume was still high in 2008 that the leasing companies examined here posted only a very low annual profit totalling €70 million after taxes – a negligible amount compared with sales. Besides the strong need for depreciation, interest expenditure also had an impact, amounting to over €2 billion as a result of the volume of bank liabilities and equivalent to around 7% of sales.

… paired with a low annual profit

Conclusion

In recent decades, leasing has become firmly established in Germany as a corporate financing instrument. Leasing is a business model that is geared, not least, to the funding needs of particularly growth-oriented and frequently high-risk enterprises. It opens up greater scope for obtaining finance for investments than would be possible with classic financing instruments on their own, thereby contributing to the dynamics of business cycles and economic activity and facilitating technology-induced structural change.

Although leasing entails the transfer of risks to the lessee and charging relatively high in-

stalment payments, this form of financing provides a considerable number of German enterprises with an attractive alternative or supplement to the classic bank loan because it involves lower transaction cost and at least temporary tax advantages as well as the fact that lease contracts may be drawn up flexibly.

The type of financing that leasing companies choose depends primarily on whether they belong to a bank or a financial services network, or to a manufacturer of machinery and equipment as group-dependent companies, or have direct links with the money and capital market. Because of their often low capital base, those that operate as independent enterprises are exposed to financing risks which can jeopardise their very existence, especially in times of crisis. By contrast, dependent enterprises can afford low provisions against risk because they are supplied with adequate finance from within the group or financial services network, regardless of their particular risk profile.

Annex

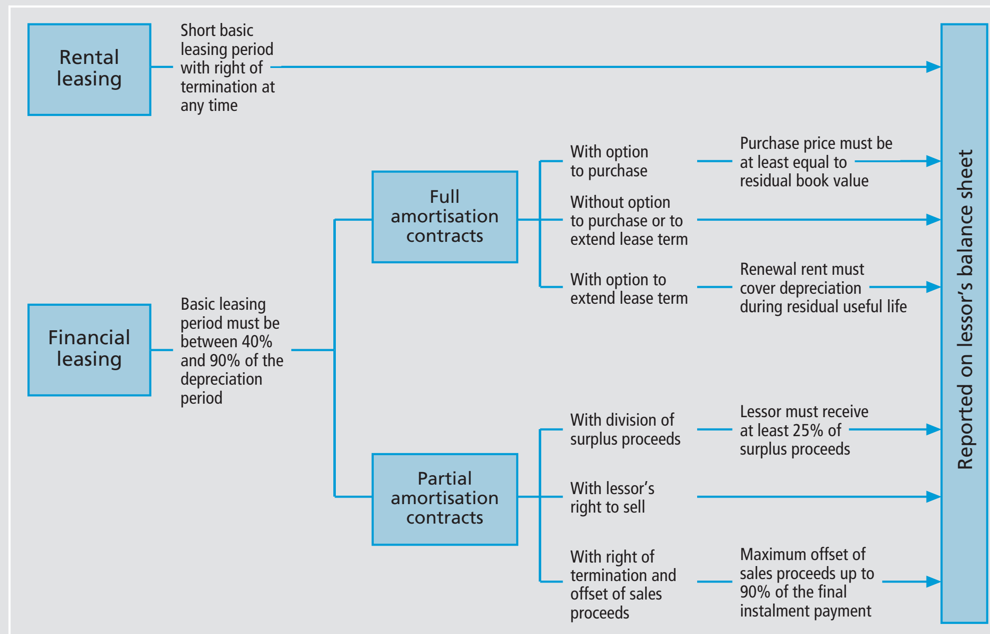
Tax rules on the financial reporting of leased assets on the lessor's balance sheet

The allocation of a leased asset for tax purposes pursuant to section 39 (2) number 1 of the Fiscal Code is based on the question of who is the economic owner. With rental leasing, this question is relatively easy to answer. Because the lessee can terminate the rent agreement at any time, the main economic risks inherent in the leased asset remain with the lessor. Moreover, the user cannot preclude the civil-law owner from exercising any control over the economic good. As a result, in this case the economic good is attributable to the lessor.[15]

The situation is much more complex in the case of financial leasing, however. Here, the individual contractual arrangements have to be examined, for which the leasing decrees provide the relevant decision criteria. To assess the tax treatment and for tax allocation purposes, a differentiation is made, first, between partial and full amortisation contracts. With the latter (full payout contracts), it is agreed at the outset that the lessee's leasing payments will cover the complete cost of acquisition or production, the financing and administrative cost as well as the lessor's profit mark-up. With partial amortisation contracts (non-payout contracts), under which the leased asset has a residual value at the end of the leasing period and the leasing payments made during the term cover only a portion of the lessor's income and expenses components, the lessee – who is contractually obliged to make good any difference between the residual amortisation and the purchase price – bears the risk of a loss in value.

15 The summarised description refers only to contracts which, according to the decrees issued by the German tax authorities, require the lessee to report the leased assets on his balance sheet, as well as to the leasing financing of machinery and equipment. The rules apply analogously to real estate lease contracts; however, given the disproportionately larger number of agreement options, it is now virtually impossible to standardise such contracts.

Forms of movable property leasing
which require balance sheet reporting by lessor



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As a basic prerequisite for tax deductibility – and this applies in like measure to partial and to full amortisation contracts – it first has to be assured that the basic lease term is between 40% and 90% of the average useful life according to the relevant tables for tax write-downs. If the lower bound is undershot, legislators assume abuse of law, because a lessee acting as an economic agent would not be prepared to assume the lessor's total costs and profit mark-ups in such a short basic lease term. Such contract arrangements would be advantageous to the lessee only if he could subsequently purchase the leased asset at particularly favourable conditions; this would suggest a hidden hire-purchase agreement and would therefore have to be reported on the lessee's balance sheet. If the upper bound is overshot, it must be assumed from the financial authorities' viewpoint that the lessor is *de facto* excluded from the predominant part of the useful life of the asset and that ultimately a good nearing the end of its useful life will be returned to him. Within the meaning of section 39 (2) of the Fiscal Code, therefore, only the lessee can be considered the economic owner; thus, the lessee has to state the leased asset in his balance sheet.

Where full amortisation contracts are concerned, provided the parties observe the basic limits for the period of use, the leased asset must always be attributed to the lessor unless the contract additionally contains an option to purchase or an option to extend the lease term. In such cases, the question of whether the lessor is precluded on a permanent basis from having any control over the leased asset, giving rise to a leased asset which for tax purposes must be reported on the lessee's balance sheet, depends on the probability that the lessee

will actually exercise the option. If, in cases in which the lease term is extended, the subsequent leasing payments are lower than the depreciation that is to be charged during that period according to the tax rules, or if the agreed purchase price is below the calculated residual book value for tax purposes, it must be assumed that the lessee will exercise the option and is therefore to be deemed the economic owner. In the case of special leasing, economic ownership always rests with the lessee, as the lessor is precluded from future use of the leased asset if only because of its specificity.

With partial amortisation contracts, the answer to the attribution question takes its bearings primarily from the criterion of whether, at the end of the period of use, the lessor can take advantage of the opportunity of an increase in value, or whether – in the case of extraordinary impairment – the lessor always has to bear the risk of loss. If, according to the overall picture of the contractual arrangements, both the substance of and the income from the leased asset remain in the lessor's ownership sphere, the economic good in question must be stated in the lessor's balance sheet for tax purposes. Where a contract provides for the surplus proceeds to be divided, the law assumes that the lessor still participates in the increase in value to an economically sufficient extent if he receives at least 25% of the part of the sales proceeds that exceeds the residual amortisation.

When a contract provides for the lessor's right to sell the asset at the end of the basic lease term, only the lessor has the possibility of benefitting from an increase in value since the lessee cannot force the purchase of the asset. Of course, the lessor is under no obligation to exercise the right of sale. In this case, too, therefore, the asset is reported on the lessor's balance sheet.

Under partial amortisation contracts with a right of termination and an offset of the sales proceeds, a maximum of 90% of the selling price may be offset against the lessee's final payment covering the residual amortisation. Surpluses accrue to the lessor. However, if the selling price does not cover the lessor's total costs and profit mark-up, the lessee is required to make a final payment equal to the difference. When a contract contains elements such as these, any increase in value that occurred during the basic lease term is passed in full to the lessor. Because the lessor is not only the legal but also the economic owner, the leased asset must be reported in the lessor's balance sheet.