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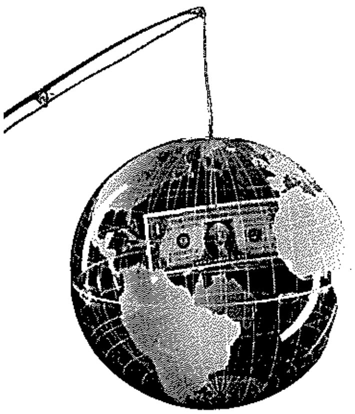
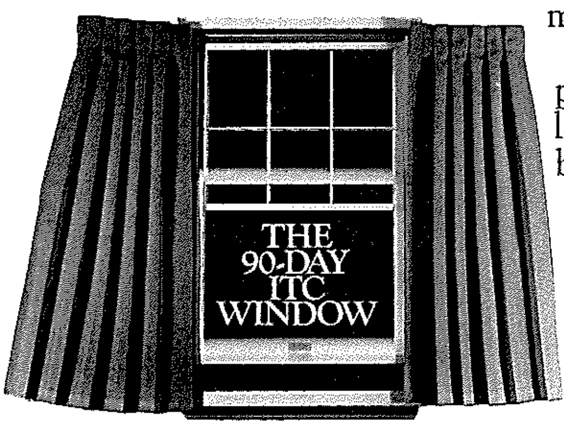


After providing a brief history of the development of the equipment leasing industry outside the U.S. and an analysis of the position of U.S. multinational leasing firms in that market, the author examines constraints upon the growth of the industry and recommends government action that will facilitate industry expansion and the accompanying increased export of U.S. goods and financial services.

The Tax Equity and Fiscal Responsibility Act of 1982 amended section 48(b) of the Internal Revenue Code to postpone the "originally placed in service" date for Investment Tax Credit (ITC) purposes for up to three months. The language seems to permit sale-leasebacks and other lease structures to vest ITC for new section 38 property in the lessor, even after equipment is used by the lessee. In this article, the author examines the pitfalls and benefits of various structures utilizing this 90-day window, with particular emphasis on multiple-item transactions and the role of the leasing company. An addendum to the article is included based upon the revisions made in the 1984 tax bill.



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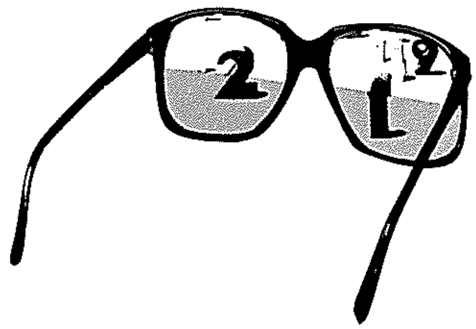
Toward a New Understanding of Leveraged Lease Profitability — 34

By Edward P. Brennan

Existing leveraged lease analytical methods and structuring techniques are premised upon the concept that a leveraged lease is a "unitary" opportunity. This concept, in the author's opinion, has resulted in a twenty-year history of confusion in measuring the profitability of a leveraged lease. The article reviews the history, development and inadequacy of the existing major analytical methods and structuring techniques, and proposes a new, simple and "foolproof" approach, the Binary Lease Profitability Index, for evaluating the profitability of a leveraged lease. The new approach is based upon perceiving the leveraged lease as presenting the investor with two distinct opportunities (hence, binary), an investment opportunity and a financing opportunity, which need to be evaluated separately.

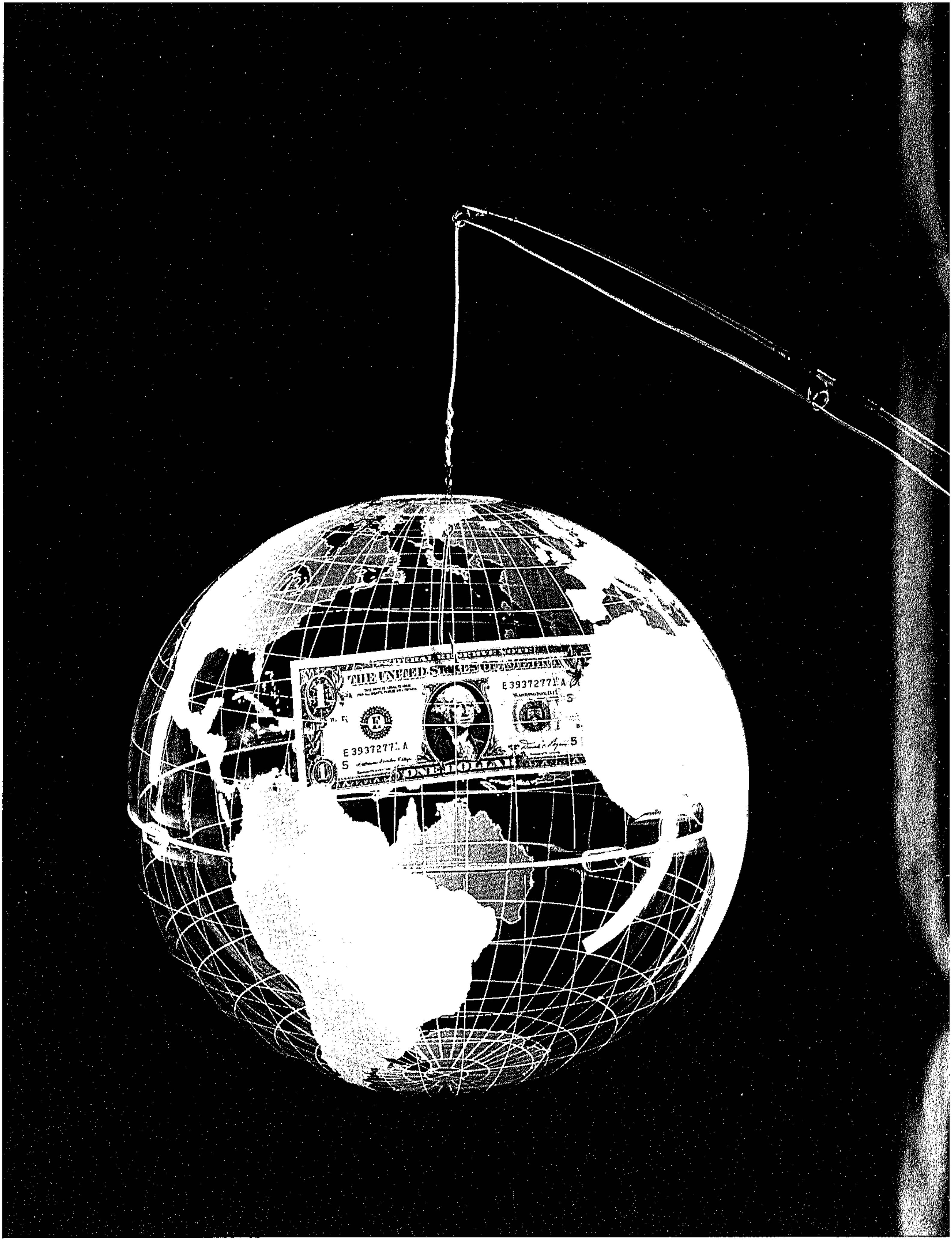


Wrap Leases: — 44

Structural and Tax Considerations

by Allen P. Palles, Esq.

The article discusses the fundamental economic, structural and tax aspects of the wrap lease, identifying it as a structural variation of the leveraged lease.


THE UNITED STATES

INTERNATIONAL LEASING: A Dynamic Industry under Constraint

by Lawrence M. Taylor, Jr., Esq.

Equipment leasing is undergoing unprecedented growth around the world. Most U.S.-based lessors participating in the growth of the industry abroad have been the large multinational financial institutions, who have aggressively pursued opportunities to expand into developed and developing foreign leasing markets. Whether this international expansion continues apace depends in large part on whether U.S.-based international lessors can maintain and improve their competitive position abroad.

This article provides a brief history of the development of the leasing industry outside the U.S. and an analysis of the position of the U.S. multinational leasing institutions in that industry today. In addition, it examines the constraints imposed by both U.S. and foreign governments which impede further growth of the industry. It concludes with a series of recommendations which would streamline U.S. government programs facilitating international leasing and provides U.S. officials with a working list of trade barriers in foreign markets affecting the "exportability" of the U.S. leasing business. The implementation of these recommendations will allow U.S.-based lessors to compete with renewed vigor in foreign markets.

The Growth of Leasing Worldwide

To the world leasing community, "leasing" generally connotes "financial leasing," wherein the lessor provides a financial service by purchasing equipment selected by the lessee for its use over a period normally less than the useful depreciable life of the asset.

Total rental payments during this initial and noncancellable lease term amortize the full capital outlay and interest cost of the lessor and provide some profit. The lessee bears the risk of obsolescence during the lease period as well as the risk of equipment loss or damage, takes care of all maintenance and pays all insurance and taxes. At the end of the lease, the lessee may have one or more options (depending on the legal, tax and accounting treatment accorded the leasing transaction in the lessee's country): To purchase the asset, at a set or determinable price or at the fair market value of the asset at the end of the term; to return the asset to the lessor; or to extend the term of the lease.

The term "international leasing" as used by the leasing community encompasses two broad and distinctly different kinds of transactions: (1) *Cross-border leasing*, where the lessor is located outside the country of the lessee; and (2) *foreign leasing*, where the lessor is an entity domestic to the lessee's country, but is wholly or partially owned by an entity located outside the lessee's country.

The variety of financial products and techniques falling within these two broad categories of financial services have been utilized by the worldwide financial community for export purposes to provide new sources of profit and diversification and meet competitive pressures abroad generated by the rapid growth of the leasing business in many countries. The fundamental concept of separation of use and ownership of a capital asset and the consequences which logically flow from that concept have provided a sustained

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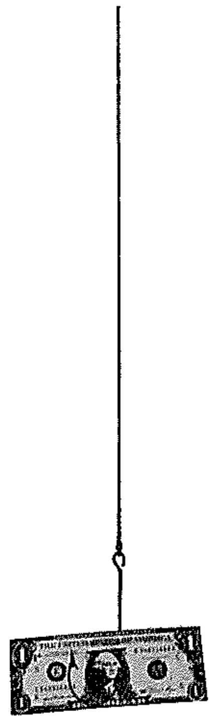
impetus for the rapid expansion of the worldwide leasing industry. Recognition by innovative financial institutions that *use* rather than *ownership* of capital equipment generates profits, and the gradual acceptance of this fundamental departure from more conventional methods of obtaining medium-term credit by both government and private industry worldwide has resulted in a service industry growing in most markets at a rate well ahead of the rate of general inflation.

The parallel development of a wide variety of tax and fiscal incentives offered by many countries to investors in capital equipment, and the use of the leasing device to allocate these incentives between the lessor/owner and the lessee/end user have been the principal factors fueling the growth of the industry. In addition, leasing has been aggressively marketed by lessors as a financial service, with emphasis on rapid response and a financial proposal tailored to the needs of the customer, and as a result has been increasingly perceived by industry as a viable alternative method of capital equipment financing, especially in times or places of limited capital availability.



Leasing traces its roots back to the early 1950s in the United States. Its use spread rapidly throughout the U.S. and the industrialized countries of Europe in subsequent years, led at first by independent nonbanking leasing corporations and followed by the large U.S. and United Kingdom multinational banks and financial institutions and their affiliates. In the 1970s, the leasing industry reached maturity in most developed countries. By the end of that decade, Organization for Economic Cooperation and Development (OECD) countries in the aggregate expended in excess of U.S. $50.0 billion on leased equipment, and investments in leased equipment as a percentage of total investment in capital equipment in OECD countries ranged from approximately 1.5% to 15%.[1] In the U.S., the domestic leasing business has enjoyed a twenty-year period of rapid growth. It is estimated that in 1983, U.S. lessors financed approximately U.S. $61.0 billion in new capital equipment representing approximately 17% of all such new investment.[2]

The "internationalization" of the leasing industry was slower to develop, but in recent years has become what has been termed an international phenomenon.[3] Many of the larger U.S. institutions were first attracted to the international leasing business by the availability of investment tax credit (ITC) and accelerated depreciation to U.S. owners of certain transportation and related assets (e.g., aircraft, rolling stock, vessels, drilling rigs, and containers) located and used primarily outside of the U.S. By structuring a transaction as a U.S. cross-border leveraged lease, where title to such assets resides with a U.S. taxpayer despite its use overseas by a foreign non-U.S.-taxpaying entity, a U.S. lessor is able to significantly reduce the financing cost to the foreign lessee of these types of assets, many of which are manufactured in the U.S. In dollar volume and in the number of international leasing transactions receiving publicity, this type of "tax-oriented" international leasing transaction is best known to the worldwide financial community, if only because of its full utilization of the leasing technique to maximize available incentives. Indeed, the U.S. is the world leader in cross-border leveraged leasing of these narrow categories of capital assets solely because of the impact of such U.S. tax incentives in the financing cost.

However, even though cross-border leveraged leasing has in past years generated a huge dollar volume of exports falling within these groups of capital equipment, its use today is relatively flat. This is due to a number of related factors:

- The strong U.S. dollar and worldwide recession has drastically reduced demand for such big-ticket items.
- Although the equipment falling within these categories represents a large dollar volume of export, the categories are very narrow when compared to the other categories of exported equipment to which such tax benefits are largely inapplicable. These other

equipment types will be much more likely to be the subject of a domestic U.S. lease, where full tax benefits are available, rather than a cross-border lease in which the risk, being foreign, is most likely higher, but the overall yield to the lessor is lower. The U.S. tax structure has resulted therefore, albeit unintentionally, in placing the vast majority of big-ticket equipment at a comparative and very significant financing cost disadvantage to that falling within transportation-related categories.

- The complexity of legal, tax and accounting problems associated with cross-border transactions, the requisite ability to assess international credit and political risk, and the innovative but complicated use of export credit devices and cover for foreign exchange risks, have required a good deal of financial and legal sophistication and resulting high cost. This has further restricted the use of cross-border leasing to the financing of big-ticket items, where the benefits significantly exceed the cost of implementation, and to the larger and more sophisticated lessors.

- Because of the way in which tax benefits applicable to these types of transactions are calculated and used, a U.S.-based international lessor with both substantial domestic U.S. leasing business as well as substantial other foreign activity is severely constrained as to the amount of such leasing transactions in which it can profitably engage.

- Last, but certainly not least, the "chilling effect" on the cross-border leveraged leasing market created by the Pickle/Dole legislation[4] now pending before Congress, has created an aura of uncertainty in the business and an unwillingness by lessors and lessees alike to enter into such transactions.

The leasing community, particularly in Europe, has developed the leaseclub system in an effort to foster international leasing. Essentially, the leaseclubs are loose associations of member leasing companies, one to a country, who refer leasing business to each other. Originally designed to reduce the difficulties involved with cross-border leasing and to improve access to foreign markets, the leaseclubs have been particularly useful in the development of vendor programs. In the programs, a manufacturer or lessor looking for lease financing in another country would be referred to a leaseclub member in the desired country. There are now five leaseclubs in existence with approximately 130 members.[5]

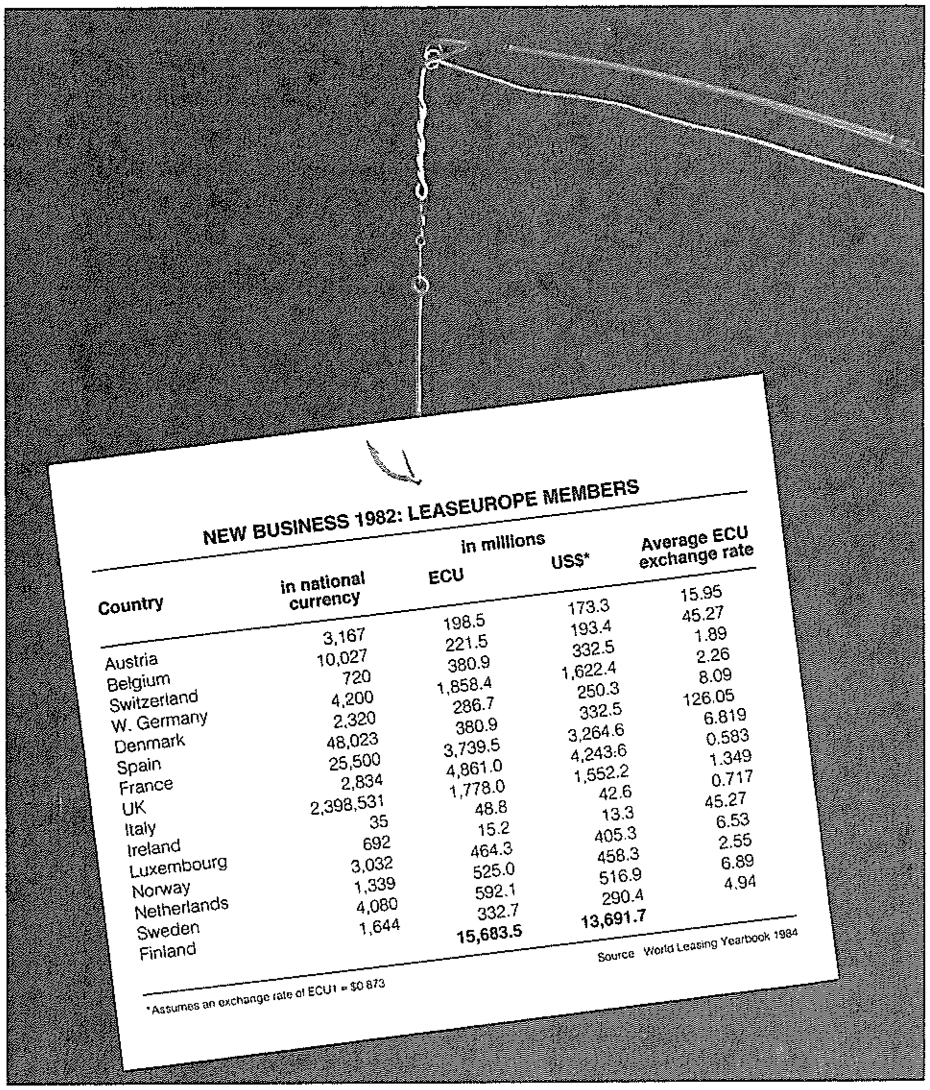
Compared to cross-border leasing, the penetration of foreign markets by U.S.-based and other foreign leasing companies has been slower and later to develop, but is rapidly accelerating. It is also undoubtedly of far greater long-term importance to the leasing industry. This method of reaching foreign acquirers of capital equipment has many advantages over cross-border leasing: The ability to handle small transactions on a purely local basis; access to the local financial markets and the resulting reduction of currency risk; direct access to and knowledge of the local leasing market and other competitive forces. However, its disadvantages are formidable: Primarily the long lead time and substantial expense of setting up and managing each such foreign company; complying with local rules of foreign investment in the financial sector; and the foreign exchange risk arising from an equity investment in a leasing subsidiary.

The larger U.S.-based lessors, particularly those affiliated with large U.S. multinational banks, have accelerated expansion of their overseas leasing presence. This has been partly in response to competitive pressures at home from other financial institutions as well as from their domestic exporting customers. There is also the competitive necessity of offering leasing to their foreign customers in countries where leasing increasingly is perceived as a viable financial alternative by both foreign financial institutions and their own customers. A recent informal survey by the American Association of Equipment Lessors (AAEL) of its members indicates that in 1983 alone approximately 10% of its members generated between $8.0 to $10.0 billion in new capital equipment leasing volume for equipment used overseas.[6] All of these institutions have made a substantial commitment of resources to the development of international leasing. While it is difficult to generalize, it is clear that of the aggregate lease receivables of each of these institutions, a significant amount (ranging as high as 30%) are due from foreign lessees.

The widespread expansion of U.S. lessors into foreign markets is more easily perceived by examining the *World Leasing Yearbook*, which provides brief summaries of the leasing industry in 41 countries, together with classified lists of over 4000 leasing companies operating around the world. A close analysis reveals the substantial commitment of the larger multinational financial institutions of U.S., Europe and Asia to international leasing. One or more of these institutions almost always is found as the whole or partial owner of the major leasing companies operating in each foreign environment.

Largely because of the involvement of these institutions, as well as the entry of local financial institutions into many of the newer foreign leasing markets, plus the growing maturity of most of the established markets, there has been a marked increase in recent years in the level of new international leasing business. The European Federation of Equipment Leasing Associations (Leaseurope), representing approximately 400 leasing companies from 16 countries, published its first annual report in September, 1981. It stated in part: "All fifteen member countries of Leaseurope had a successful year in 1980. Total new business amounted to BF 506 billion, compared to BF 398 billion in 1979 and BF 290 billion in 1978.

"The average rate of growth in 1980 was 27%, but several countries continued to enjoy exceptionally high rates, most notably Finland with a 101% increase and Italy with 69%. With the exceptions of Denmark and Ireland, all countries experienced a rate of growth above the general rate of inflation. Seven countries have



NEW BUSINESS 1982: LEASEUROPE MEMBERS

Country	in national currency	in millions ECU	US$*	Average ECU exchange rate
Austria	3,167	198.5	173.3	15.95
Belgium	10,027	221.5	193.4	45.27
Switzerland	720	380.9	332.5	1.89
W. Germany	4,200	1,858.4	1,622.4	2.26
Denmark	2,320	286.7	250.3	8.09
Spain	48,023	380.9	332.5	126.05
France	25,500	3,739.5	3,264.6	6.819
UK	2,834	4,861.0	4,243.6	0.583
Italy	2,398,531	1,778.0	1,552.2	1.349
Ireland	35	48.8	42.6	0.717
Luxembourg	692	15.2	13.3	45.27
Norway	3,032	464.3	405.3	6.53
Netherlands	1,339	525.0	458.3	2.55
Sweden	4,080	592.1	516.9	6.89
Finland	1,644	332.7	290.4	4.94
		15,683.5	**13,691.7**	

Source World Leasing Yearbook 1984

*Assumes an exchange rate of ECU1 = $0.873

more than doubled their business of the last two years.

"As in the previous year, some 35% of the total expenditure on leased assets in 1980 related to industrial plant and machinery and a further 35% to commercial vehicles and cars. 20% consisted of computers and office equipment and the remaining 10% covered ships, aircraft, railway-rolling stock and other items.

"The net book value of the leased equipment owned by leasing companies in the fifteen member countries at 31st December 1980, amounted to BF 921 billion, compared to BF 640 billion at the end of 1979.

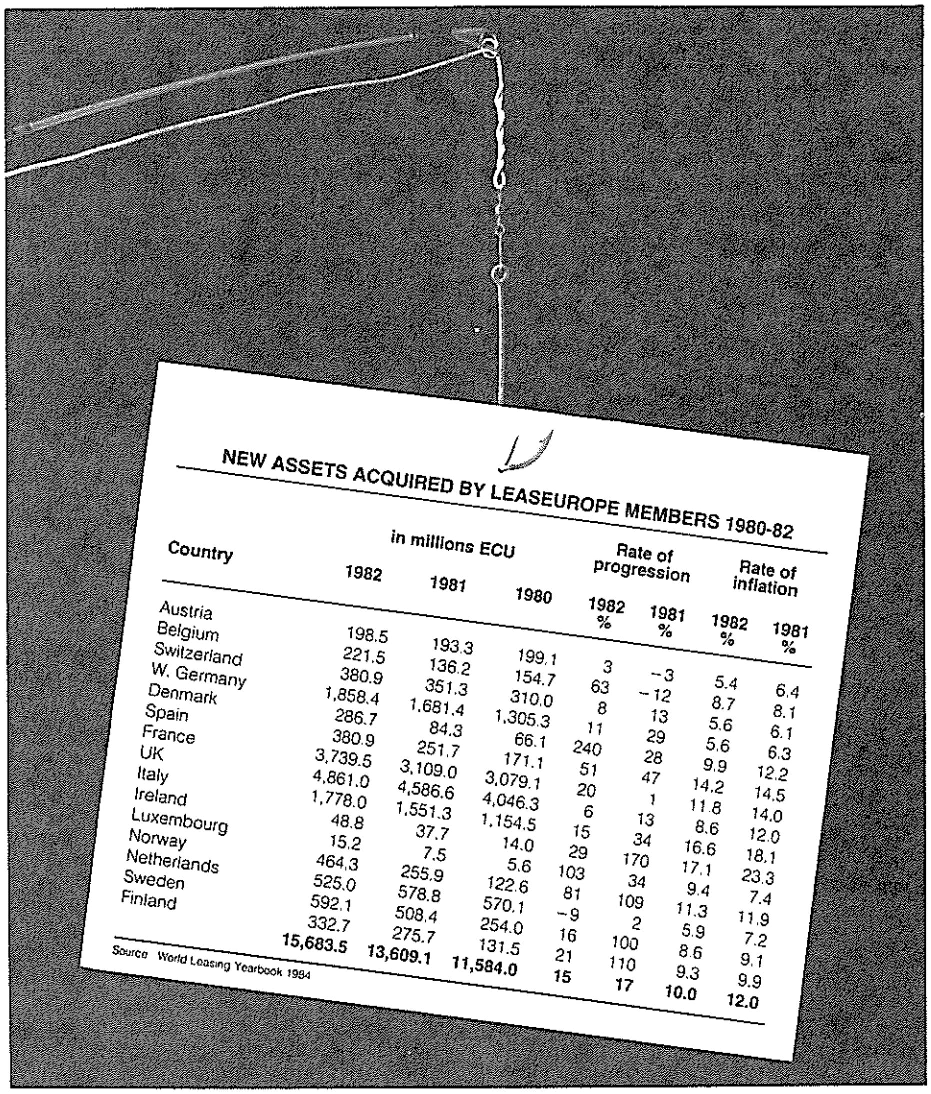
"In most cases national associations represent between 75% and 100% of the total equipment leasing business carried on in their countries, so that the combined statistics give a fair indication of the overall level of business carried on in Europe."

The 1982 statistics collated by the Leaseurope Statistics Committee showed a 15% overall increase in business, reflecting new equipment leased in Europe during calendar 1982 valued at U.S. $13.69 billion and an aggregate net book value of leased equipment owned by members at December 31, 1982 equal to U.S. $28.2 billion. See tables for details.

In the U.K., the Equipment Leasing Association (ELA) reported 572 million pounds sterling of international leasing business written in 1981 by U.K. leasing companies compared with 133 million pounds sterling in the previous year. The international business represented 21% of the new plant and equipment leased by member companies of the ELA in 1981. However, because of certain changes in the U.K. tax law, 1981's spectacular performance will not be repeated in the near future; and 1982 business was sharply lower at 94 million pounds sterling.

In the Latin American markets, growth in past years has been nothing short of astounding, although general economic conditions in that area have resulted in a sharp downturn in growth in the last year or so. In Mexico, new leasing business grew from 367 million pesos in 1970 to almost 8.0 billion pesos by 1980. Approximately a dozen major leasing companies provided the financing, all but three of whom have U.S. or European shareholders.[7] This growth has, of course, been sharply curtailed with the recent collapse of the Mexican economy; but Mexican leasing companies will undoubtedly be able to rebuild in future years due to their preeminent position as service-oriented companies supplying a substantial portion of Mexican industry's capital equipment financing needs. In Venezuela, there are over 35 leasing companies, the majority of which are owned in whole or in part by large Venezuelan or foreign banks. Figures available from the Venezuelan leasing association show that at the end of 1979 these leasing companies had total lease receivables of nearly U.S. $350 million. In fact, total lease contracts outstanding more than tripled from the end of 1977 to 1982, reaching 2.6 billion bolivares by the end of 1982.[8] This growth will also be checked as Venezuela seeks to get its financial house in order following the financial crisis of 1983. In Brazil, from its inception in 1969, the leasing industry had grown to 54 companies by December, 1980. Collectively, these companies have invested in excess of U.S. $1.3 billion in leasing transactions, accounting for almost 4% of total capital investment.[9] This growth continued through the end of 1982 when net book value of leasing transactions was approximately U.S. $2.6 billion.[10]

The leasing industry in Asia and the Pacific Basin also has seen substantial growth in recent years. It has its roots in the early 1960s in the Philippines and Japan, and spread to other Asian countries in the early 1970s, led by Japanese and U.S. multinational financial institutions. In Japan, for the year through March 31, 1983, new leasing contract receivables totalled 1,933 billion yen (U.S. $8.4 billion), a 25% increase over the previous year and representing nearly 5% of total capital investment.[11] New leasing contracts in Japan are expected to run at an annual level in excess of 2.5 trillion yen (U.S. $10.7 billion) by 1985 and 4.0 trillion yen (U.S. $17.0 billion) by 1990, with some respected estimates reflecting even higher growth.[12] The Japanese have also developed the so-called "shogun lease," a yen-dominated lease for a foreign lessee which enables such a lessee to obtain yen funding from the domestic Japanese capital markets at lower spreads and long-term fixed rates and pay off the lease with yen revenues if available from the lessee's own operations. Shogun volume is around U.S. $1.0 billion per year, and to date most shogun leases have been done with airlines, especially the regional Asian carriers with yen revenue.[13] However, the market for shogun leases is expected to grow rapidly, especially in respect to foreign lessees seeking to diversify their financing.



NEW ASSETS ACQUIRED BY LEASEUROPE MEMBERS 1980-82

Country	in millions ECU 1982	1981	1980	Rate of progression 1982 %	1981 %	Rate of inflation 1982 %	1981 %
Austria	198.5	193.3	199.1	3	−3	5.4	6.4
Belgium	221.5	136.2	154.7	63	−12	8.7	8.1
Switzerland	380.9	351.3	310.0	8	13	5.6	6.1
W. Germany	1,858.4	1,681.4	1,305.3	11	29	5.6	6.3
Denmark	286.7	84.3	66.1	240	28	9.9	12.2
Spain	380.9	251.7	171.1	51	47	14.2	14.5
France	3,739.5	3,109.0	3,079.1	20	1	11.8	14.0
UK	4,861.0	4,586.6	4,046.3	6	13	8.6	12.0
Italy	1,778.0	1,551.3	1,154.5	15	34	16.6	18.1
Ireland	48.8	37.7	14.0	29	170	17.1	23.3
Luxembourg	15.2	7.5	5.6	103	34	9.4	7.4
Norway	464.3	255.9	122.6	81	109	11.3	11.9
Netherlands	525.0	578.8	570.1	−9	2	5.9	7.2
Sweden	592.1	508.4	254.0	16	100	8.6	9.1
Finland	332.7	275.7	131.5	21	110	9.3	9.9
	15,683.5	**13,609.1**	**11,584.0**	**15**	**17**	**10.0**	**12.0**

Source World Leasing Yearbook 1984

In Singapore, the Leasing Association of Singapore at the end of 1982 represented 32 lessors, including 17 foreign-affiliated companies.[14] In Malaysia, the Equipment Leasing Association of Malaysia now has 107 members whose total leasing volume in 1982 amounted to approximately M$750 million (U.S. $330 million).[15] In Korea, there are at present three leasing companies and six merchant banks operating in the field with leased equipment cost reaching WON 202 billion (U.S. $290 million).[16] Development in Indonesia has been slow but the demand for lease financing has been strong, with more than 30 companies already engaged in leasing or planning entry into the market.[17] Hong Kong serves as a regional financial center, not only for leasing but for most other financial services, and many of the lessors located there primarily concentrate on big-ticket cross-border leasing to Asian lessees located elsewhere.[18] In the Philippines, there are approximately 40 leasing and finance entities, with an estimated total portfolio at the end of 1981 of 1.0 billion pesos (U.K. $115 million), and an historical annual growth rate of 10%.[19]

As a final note to this brief history, the efforts of the International Finance Corporation (IFC) should be cited. This private sector arm of the World Bank has introduced leasing as an alternative source of equipment finance for industrial, agricultural and commercial enterprises, has helped support the domestic capital markets of many countries and has stimulated economic development primarily in less developed countries. Since 1977, IFC has established and become an equity investor in leasing companies in fourteen countries: Colombia, Jordan, Korea, the Philippines, Sri Lanka, Thailand, Uruguay, Peru, Ecuador, Brazil, Portugal, India, the Dominican Republic, and Indonesia.[20] In addition, in some cases it has lent its own funds to the venture to insure an initial source of funds. IFC is currently investigating the possibility of future leasing ventures in Asia and Africa, and plays an active role as adviser to authorities in less developed countries in connection with the development and implementation of an appropriate regulatory framework for leasing.

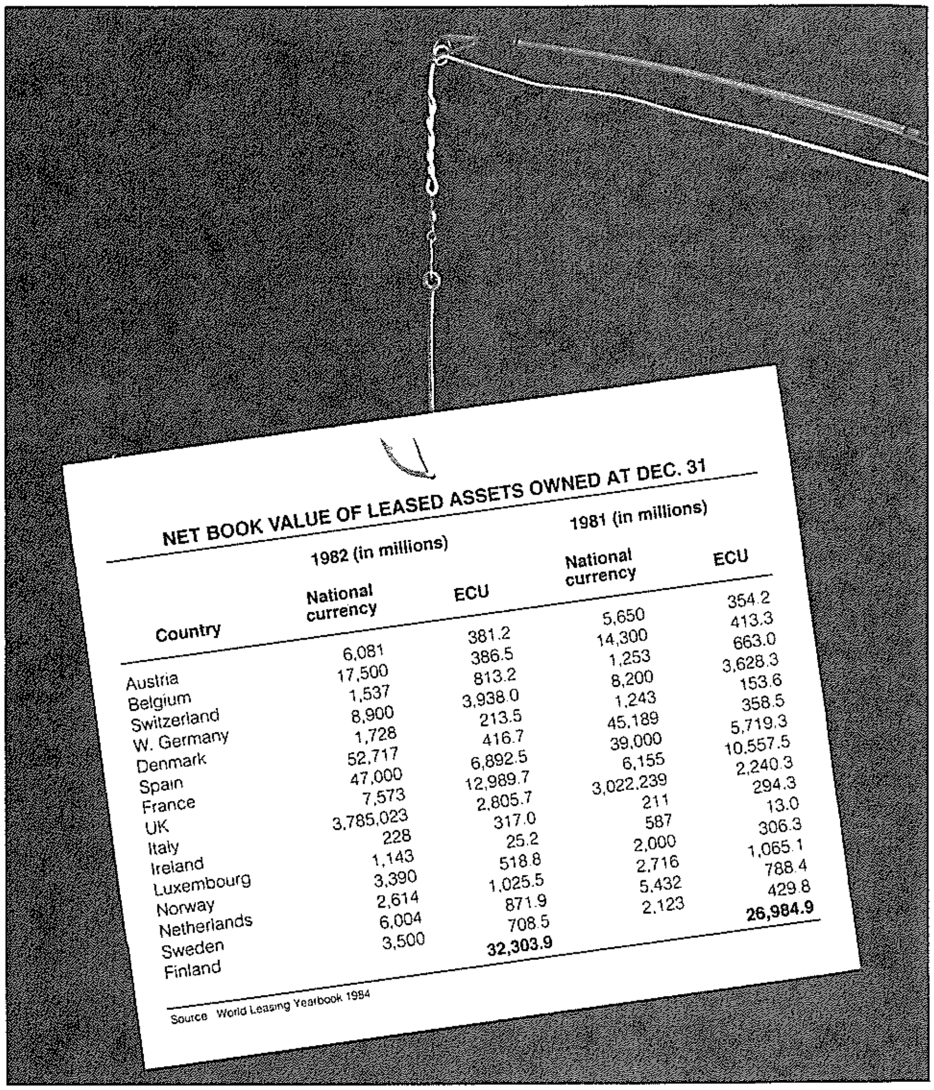
A number of trends and potential growth areas relevant to the U.S. leasing community may be deduced from both the extent and nature of this world-wide expansion of the leasing business and the limitations facing the growth of leasing in the U.S.:

(1) The penetration of less-developed leasing markets around the world by U.S., European and Japanese financial institutions, either by themselves or with local partners, has accelerated, resulting in increased and more sophisticated competition for both cross-border and foreign leasing business.

(2) In many Anglo-Saxon countries, including the U.S., leasing has derived its growth from tax incentives. In contrast, the vast majority of countries where leasing has taken hold treat leasing as an efficient and readily available supply of medium-term funds for the acquisition of capital equipment, with tax incentives taking a secondary but not unimportant position. Changes in the tax law affecting future years in the U.S., coupled with the general shortage of a tax base among financial institutions in the U.S. and elsewhere, will undoubtedly cause U.S. lessors engaged in international leasing to become less tax-oriented and more willing to explore nontax-driven markets.

(3) The need to maintain the competitive trade position of the U.S. in world markets, especially in light of the strong U.S. dollar, a 1983 foreign trade deficit of U.S. $69.4 billion (62% higher than 1982), and a 1984 trade deficit expected to exceed U.S. $100 billion, will require increased concentration on exports of capital equipment and related financing. Leasing companies will be increasingly asked by vendors/customers for lease financing for a foreign acquirer of its product. Indeed, many captive leasing companies may find a similar reason to offer leasing as a financing alternative. The recent development of "export trading companies" in the U.S. is also likely to foster the development of international leasing.

(4) The acceleration of technology, especially in the electronic area, coupled with the rise in energy and labor costs, can be expected to result in an ever more rapid replacement of obsolete equipment.



NET BOOK VALUE OF LEASED ASSETS OWNED AT DEC. 31

Country	1982 (in millions) National currency	1982 (in millions) ECU	1981 (in millions) National currency	1981 (in millions) ECU
Austria	6,081	381.2	5,650	354.2
Belgium	17,500	386.5	14,300	413.3
Switzerland	1,537	813.2	1,253	663.0
W. Germany	8,900	3,938.0	8,200	3,628.3
Denmark	1,728	213.5	1,243	153.6
Spain	52,717	416.7	45,189	358.5
France	47,000	6,892.5	39,000	5,719.3
UK	7,573	12,989.7	6,155	10,557.5
Italy	3,785,023	2,805.7	3,022,239	2,240.3
Ireland	228	317.0	211	294.3
Luxembourg	1,143	25.2	587	13.0
Norway	3,390	518.8	2,000	306.3
Netherlands	2,614	1,025.5	2,716	1,065.1
Sweden	6,004	871.9	5,432	788.4
Finland	3,500	708.5	2,123	429.8
		32,303.9		**26,984.9**

Source World Leasing Yearbook 1984

(5) The developing economies of the world, especially in Asia and Latin America, will continue to have a stronger appetite than more mature economies for new capital equipment. The advantages of leasing over other traditional methods of financing should result in the continued rapid growth of leasing.

(6) Small and medium-sized companies around the world have become more aware of the availability and attractions of leasing and can be expected to rely increasingly on leasing to fulfill their capital equipment needs.

These trends taken together illustrate the urgent need of the U.S.-based international leasing business to improve its competitive position abroad. It must facilitate its international growth by providing, in partnership with the U.S. government, an increased level of support consistent with these goals. The analysis which follows is intended to demonstrate that such increased support can be provided.

The Future: Needs and Opportunities

The classical advantages of leasing are even more attractive in less-developed economies where capital is in short supply.

(1) Leasing increases cash flow, con-

serves working capital and preserves existing bank lines.

(2) Lease financing can be more closely matched to the useful economic life of the asset than traditional term financing.

(3) Leasing usually permits financing of 100% of the cost of the asset, so there is little or no capital outlay.

(4) Lease financing is still treated in many countries as "off balance sheet" financing, although this is of diminishing importance as methods of accounting for leases gain in sophistication around the world.

(5) Leasing offers the opportunity for lessor and lessee alike to make maximum use of tax benefits and other fiscal incentives encouraging new investment in capital equipment.

(6) Leasing may enable an expanding company to circumvent spending limits or other restrictive loan covenants in its existing financing arrangements.

In the international market, leasing takes on several additional advantages for the prospective lessee which can often mean the difference between acquiring or not acquiring new capital equipment. Capital may not only be in short supply or exceedingly expensive, it may be simply unavailable through traditional means of financing. Easier access to the international capital markets through the leasing device is proving of vital importance in many less-developed countries. In fact, in many markets, leasing has grown to be the primary source of medium-term capital equipment financing, often with rates and terms far more attractive than those available on local markets. In addition, because of the traditionally competitive leasing environment and the characterization of leasing as a financial service, leasing companies are viewed as more responsive than local banks and other sources of capital to the needs of their customers and more flexible in developing financial packages.

Other less tangible advantages are also important. The separation of use from ownership can be important in high-risk environments. The employment of a lease rather than a loan in less-developed countries may avoid the appearance of a high debt to the West. A lease can be structured to give the lessee a choice or mixture of currencies for repayment, thus providing better management of currency risk and better asset/liability matching.

The vendor/exporter who can offer leasing to overseas customers, in addition to other financing alternatives, clearly will gain a competitive edge in a world market increasingly conscious of the high cost of financing. An increase in export sales is a likely result. In addition, the development of a working relationship with a leasing company willing to finance the vendor's product in one or more overseas markets under a classic "vendor program" will help accelerate the credit analysis and decision-making process with respect to such foreign customers and will enable the vendor to insure an adequate supply of funds at a cost known in advance. The vendor can even realize a better control over the after-market in used equipment, through remarketing or repurchase arrangements with the leasing company. In an era of flat or falling domestic productivity, the availability of the leasing device can be of critical importance to the manufacturer seeking to increase its sales overseas.

Lastly, a lessor offering leasing as an international financial service can realize a significant new source of profits, greatly expand its existing customer base and provide increased service to its exporting vendor/customers. Creative transaction structuring, making maximum use of available export funding and tax and other fiscal incentives, often can result in significantly higher yields on funds employed than in the domestic market. In addition, having title to an asset rather than a mere lien or security interest will often give the lessor a higher degree of security in the event of a default by a lessee. In many cases, this will make the transaction easier and less expensive to document. The development of both public and private credit risk and/or political risk insurance programs geared to the leasing device also offers the international lessor additional protection against the increased risk inherent in medium-term financing overseas.

However, it is just as clear that there are a number of problems which must be addressed by both the public and private sector if the U.S. leasing industry and U.S. manufacturers are to remain competitive in the current world trade environment and realize the growth opportunities presented. These problems are in large part interrelated and essentially revolve around the twin issues of *yield* and *risk*. "Yield" is the total after-tax return to the lessor in any given transaction. "Risk" is the quantification and analysis of all those factors inherent in any given transaction which affect the lessor's perception of lessee ability to repay and, if repayment does not occur, the existence of other remedies and the ease and rapidity with which they can be exercised. In a free market, yield and risk are directly proportional; the higher the perceived risk, the higher the yield, and vice versa. If a contemplated activity does not meet yield requirements at least as high as other domestic or international financial activities, or if the risk perceived is greater than the anticipated reward for engaging in such financial activity, then there is little or no incentive from a purely financial point of view to engage in that activity. It is no different in the leasing business.

Following is a brief summary of the major impediments to the expansion of the international leasing business which affect these two basic factors and which are found within our own U.S. institutions and regulatory framework.

RISK

In general, neither U.S. financial institutions nor U.S. manufacturers of capital equipment, except for the very largest and most sophisticated of each, have ever had attractive incentives to export their products and services. The U.S. domestic market for each is so large, foreign markets are so fraught with peril and uncertainty, and the complexity of issues facing an exporter or a financier without considerable expertise are so overwhelming that many make a deliberate choice to forego export markets. Lessors examining potential overseas markets see unquantifiable or, at best, increased risks including an inability to assess political and credit risk, an inability to protect against these risks should they materialize and, more generally, uncertainties in any given foreign market which may affect the viability of the transaction itself.

Failure of our government to address these risks include:

(1) *The lack of a well-publicized, simplified and flexible export credit insurance program covering export financing through leases*—It is crucial to the U.S.-based lessor's ability to extend activities to foreign markets that the U.S. government develop an export credit and political risk insurance program which encompasses lease transactions of exported equipment. Although the U.S. Export-Import Bank (ExImBank) and the Foreign Credit Insurance Association (FCIA) have a lease program in place, neither organization has a staff familiar with leasing, and neither has given the program any support or publicity. The program itself has been little used, largely because of its lack of flexibility and its failure to permit international lessors to offer leasing customers many of the traditional advantages of leasing (e.g., 100% financing).[21] ExImBank and FCIA have periodically undertaken a review of the existing program, but such past reviews, despite support at the highest levels of ExImBank, amount to little more than lip service to the leasing industry. Any substantive changes are anticipated to be slow in coming, if at all. ExImBank has currently initiated another review of the program in coordination with leasing industry representatives, and it is hoped that a new leasing program can be devised and implemented which will meet the needs of the leasing industry.

There are signs that other developed exporting countries and their respective counterparts to ExImBank and FCIA are also feeling considerable pressure to revise the internationally agreed-upon framework for export-related credit insurance and subsidies. ExImBank/FCIA have traditionally rested their long-standing resistance to unilaterally developing an effective export credit insurance for leasing on this framework.[22] The Organization for Economic Cooperation and Development (OECD), of which the U.S. and most other industrialized countries are members, has undertaken in early 1984 an extensive review of the role of OECD-based financial institutions in financing the development process through leasing. While the results of this review will not be available to member countries until mid to late 1984, it is hoped that the results will evidence both the important role leasing can play in the development of capital markets in less-developed countries (LDCs) and the urgent need for each OECD country to develop effective and usable lease credit insurance programs.

Another positive note in this area has been the development of an insurance program by the Overseas Private Investment Corporation (OPIC), a self-sustaining U.S. government agency whose purpose is to promote economic growth in LDCs by assisting the U.S. private sector there. Coverage under a comprehensive political risk insurance program providing coverage to international lessors engaging in cross-border leasing is now available. However, the program is one of relative low visibility, offering coverage of only certain well-defined political risks, and does not, for statutory reasons, cover any credit risks. In addition, because of its focus on LDCs, OPIC has been unable to attract U.S. lessors who have their focus on larger and more economically viable markets.

(2) *A lack of a centralized source of information and expertise covering international leasing*—There is a general absence within the various departments and agencies of the U.S. government of any sources of information covering issues which are likely to arise in a contemplated foreign lease transaction. Although much of the information can be provided by foreign counsel knowledgeable in the leasing business, there is a good deal of general threshold information which could be provided by ExImBank and/or the Commerce Department.

Information on a variety of areas, all related to the particular foreign market in question, is necessary and generally falls into the following categories:

- "Doing business" issues such as the right of a foreign company to engage in the lease of personal property, registration, continuing regulatory aspects and limitation of activities;

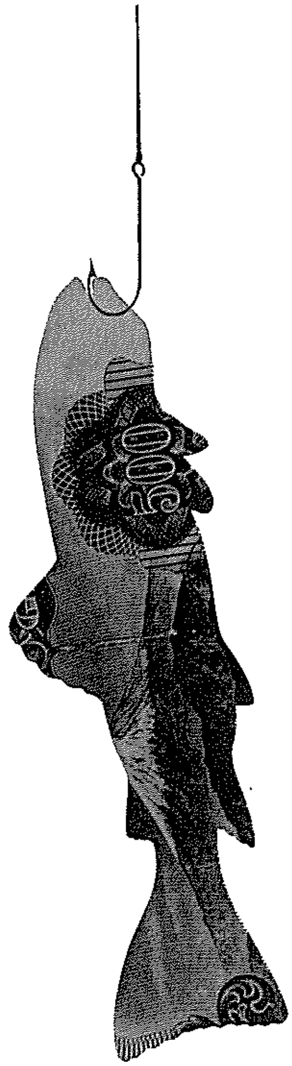
- Monetary issues such as exchange controls, restrictions on foreign investments, and currency parity if other than a local currency is used as a base for lease payments (e.g., restrictions on remittances, convertability limitations, necessity to register lease transactions to insure ability to repatriate funds, and potential effects of a devaluation of the local currency);

- Tax issues peculiar to the foreign market under consideration, such as the availability of allowances on the capital cost of the equipment and who can claim them, permissible methods of depreciation, tax treatment of rental income to the lessor and of rental payments by the lessee, tax treatment of equipment disposal proceeds and the use of renewal or purchase options;

- Import restrictions and other customs problems relating to the import of foreign equipment and the duties assessed thereon;

- Problems relating to the protection afforded an equipment lessor's interest in leased assets, both at the outset and upon and after a default by a lessee (i.e. creditors rights generally, the existence of a well-defined leasing law, rights of lessor in the event of claims by third parties or of bankruptcy of the lessee, ability of a lessor to repossess and/or repatriate the leased equipment);

• Permitted provisions of a lease contract (e.g., "hell or high water" clauses, applicability of laws in respect to the sale of goods and any warranties attaching thereto, and civil liability problems).



YIELD

The nature of the leasing business worldwide as an innovative and adaptive financial service utilizing a variety of new techniques by which companies may more expeditiously fulfill their capital equipment requirements is the very reason why an extension of credit through leasing usually commands a higher yield to the lessor than a more traditional loan transaction. The usually greater assumption of credit and collateral value risks by a lessor, coupled with the ability to identify and quantify all of the various profit factors, including tax benefits, and to allocate these most efficiently through creative structuring, clearly justifies an increase in overall yield to a lessor. It is an undeniable fact that the U.S. leasing business is largely dependent for its growth and profit on its ability to use U.S. tax benefits which flow from the ownership of capital equipment. Given the finite resources of leasing companies and the current domestic U.S. market permitting relatively high yields in leasing transactions, the majority of U.S. lessors have found that, except for the big-ticket leveraged leases of transportation-related equipment, most international leasing transactions are not as attractive as domestic transactions. Pricing cannot both offer a profit in excess of the yield resulting from a comparable domestic U.S. transaction, and still remain competitive to the foreign lessee. Even if the lessor can price attractively a cross-border leveraged lease in which U.S. tax incentives make up a significant component of its after-tax yield to the lessor, such tax benefits may be unusable on its U.S. consolidated tax return.

These yield-related problems may be capsulized as follows:

• *The lack of a competitive program of export funding relative to leasing*—Despite the need for U.S. exporters of capital equipment to offer financing packages for their products which are competitive with those offered by other exporting industrialized countries, the ExImBank has reserved its limited funding resources for a small group of big-ticket traditional transactions. ExImBank has been unable or unwilling to devote the human resources necessary to develop and promote programs, among them a leasing program, available to a broader range of U.S. financial institutions and exporters. The Bank has traditionally pleaded lack of financial resources in this area, with some justification given its constant battle for funding appropriations and, indeed, for its very existence.

• *Lack of U.S. tax incentives available for equipment leased overseas*—Generally, a U.S. lessor of capital equipment leased to a U.S. lessee under a so-called "guideline lease" is treated as the owner of the equipment for tax purposes. The lessor is therefore entitled to receive U.S. tax incentives, principally investment tax credit and depreciation. As for the availability of ITC to equipment leased by a U.S. lessor but used outside the U.S., the general rule is that this property is not eligible for ITC.[23] The exception to the general rule lists certain categories of mobile and transportation-related equipment which are eligible for ITC regardless of predominant use.[24]

With respect to depreciation allowable on leased equipment, the rules in existence prior to 1981 depended on the nature of the asset and its expected useful life, and did not set up any serious inequities based on where the equipment was used. However, in an effort to stimulate U.S. productivity, the passage of the Economic Recovery Tax Act of 1981 (ERTA) dramatically changed the rules with the introduction of the accelerated cost recovery system (ACRS). ACRS established four categories for depreciation—three, five, ten and 15-year property—with most capital equipment depreciated over five years. However, a separate set of less favorable recovery rules applies to assets used predominantly outside the U.S. The "recovery period" for non-U.S. personal property is the asset depreciation range (ADR) midpoint in effect on January, 1981 (12 years if the asset has no ADR class). The recovery percentage allowable is based on the 200% declining balance method with a switch to straight line at the optimum point.

The foregoing tax structure has essentially restricted the cross-border leasing business to that limited group of assets qualifying for ITC and accelerated depreciation under ACRS. However, even these well-defined exceptions are now under attack by several pieces of legislation now pending in Congress, the Pickle-Dole legislation cited earlier. The Pickle-Dole bills would extend the denial of investment tax credit and accelerated depreciation to any property used by any foreign person when income from the property is not subject to U.S. tax. Should these proposals be enacted, U.S. lessors engaged in this kind of leasing would be placed at a severe disadvantage with foreign lessors. More important, U.S. exporters would find that the cost of their products will significantly increase abroad and that many prospective foreign customers will fill their equipment needs with foreign manufacturers who can offer more attractive financing.

- *Inability of U.S. corporations to use available tax incentives*—Generally, all U.S. corporations are subject to U.S. income tax on their worldwide income, including "foreign source income." If foreign source income is also subject to a foreign income tax, the IRS allows such tax as a credit against the U.S. entity's tax liability. However, under Section 904 of the Internal Revenue Code, the amount of foreign tax creditable in any one tax year is limited according to the following formula:

$$\frac{\text{foreign taxable income}}{\text{total taxable income}} \times \text{U.S. tax (on taxable income)}$$

Because of the availability of some form of depreciation and ITC in selective cases of equipment used outside the U.S., it is probable that "foreign source losses," rather than foreign source income, may be produced in a leasing transaction where the leased property is used outside the U.S. This can have a significant adverse effect on the tax position of a U.S. lessor already paying substantial creditable foreign taxes. It reduces both the numerator and denominator of the above-mentioned fraction, thereby reducing the amount of U.S. tax liability against which foreign tax credits may be applied. In such a situation, a leasing company contemplating an international leasing transaction may be effectively precluded from entering into it. Moreover, since the calculations required by the IRS in computing foreign source income/loss occur prior to the utilization on a U.S. tax return of any domestic U.S. tax benefits, principally ITC and depreciation, a leasing company conducting a substantial tax-oriented domestic business may find itself in an even worse position by being unable to fully utilize domestic tax incentives on which the profitability of U.S. tax-oriented leasing largely depends.

Another tax disincentive to engage in international leasing is found in a section of the Internal Revenue Code known as "Subpart F." While a detailed treatment of Subpart F is beyond the scope of this brief summary, its provisions generally apply to foreign corporations controlled 50% or more by U.S. shareholders (controlled foreign corporations) which can be made liable under certain circumstances for U.S. income tax on certain undistributed income (Subpart F income). Under certain circumstances, lease rental income and interest income earned by a leasing company organized under the laws of a foreign country but classified as a controlled foreign corporation could be subject to current U.S. income tax, even if income is not distributed to the owners.

In addition to these problems found within our own institutional structure, there is also a wide variety of problems faced by U.S. lessors in otherwise attractive foreign markets. These problems have deterred all but the largest and most sophisticated of U.S. lessors from committing the resources necessary to develop a meaningful and continuing international leasing program. These large U.S. lessors, along with their European and Asian counterparts, have demonstrated admirable innovation and adaptability in their aggressive pursuit of foreign market share, and as a result have largely prospered from their hard work.

Impediments

The following section is intended to graphically illustrate those restrictions and impediments which prevent U.S. lessors from competing fairly and effectively in many foreign markets. Certainly, many of these complaints are also true for nonfinancial sectors of U.S. business seeking to compete in foreign markets. This should give our government a greater incentive to work toward a resolution of common problems.

In addition, many of the constraints simply have arisen because foreign governments have failed to legislate as quickly as required the changes necessary to adapt their respective legal and tax systems to the needs of the international leasing industry. Leasing's rapid growth has simply outstripped the ability of such governments to evaluate the benefits of this new financial tool to their own economies against other competing national policies. Governments have not kept pace with multinational leasing companies who see financial gaps to be filled and market opportunities to be pursued. But those foreign governments which have actively encouraged technical assistance from foreign lessors in promulgating new leasing legislation and in fostering the growth of a domestic leasing business through adaptation of their capital markets are expected to reap economic benefits throughout their economies.[25]

The following discussion also is intended as a working agenda for the U.S. government when dealing with foreign governments on issues affecting the export of U.S. service industries in general, and the export of U.S. capital and expertise in the leasing business in particular.

CROSS-BORDER LEASING

◆ *Restrictive effects of withholding taxes*—Most countries, including the U.S., levy a "withholding tax" on a variety of remittances to entities located outside its taxing jurisdiction as a means of taxing income earned within its borders but not otherwise taxable. It is called a withholding tax because it is withheld at the source by the obligor remitting to the foreign entity. Most countries, whether by an across-the-board ruling or by specific tax treaties between itself and other powers, include *inter alia* a category for interest remitted abroad. However, remittances to be made to a foreign lessor often may be accorded treatment inconsistent with the financial characteristics of the transaction, either because the existing rules simply did not contemplate financial leasing when agreed upon or because no rules exist at all. This can have the anomalous effect of taxing lease payments at a much higher rate than interest income, or of taxing the entire lease payment without any attempt to allocate between the principal and interest components of a given payment. This is a complicated subject because of the ingenuity of lessors in structuring a wide variety of leases with varying payment structures; however, the intent in all cases should be to place a financial lease on an equal tax basis with a comparable loan.

◆ *Restrictions on terms of financing*—In deciding whether to enter into a cross-border lease, a U.S. lessor first must examine the powers it may exercise and the restrictions applicable to it as a foreign entity. Its powers and rights may be limited when compared to a domestic entity, and it even may be excluded from whole segments of the economy or from owning certain assets otherwise financable through a loan. It may find in any given transaction that the transaction itself may face lengthy and expensive qualification and registration procedures at the central bank, finance ministry or the like, whose approval may be purely discretionary and often designed to restrict or exclude certain transactions. Such approval procedures may also require transactions to conform to a variety of transactional parameters, perhaps even against the desires of both the lessor and lessee. These may include a maximum effective interest rate, a minimum or maximum lease term, and even required grace or amortization periods. A lessor may find that certain government subsidies (e.g., tax holidays, grants, tax forgiveness, or equivalents to the U.S. investment tax credit) which are available if the proposed lessee had acquired title to the asset, are often not usable by either a financial lessor or the acquirer of the equipment, thus putting the proposed lease on an uncompetitive footing when compared to a loan of similar terms. Once the lease is consummated, remittances to be made by the lessee may face further problems of an exchange control nature, such as restrictions on remittance to the lessor or convertability limitations if the lease payment is denominated in a currency foreign to the lessee.

◆ *Limitations on importation of capital equipment*—Many countries limit or exclude imports of certain kinds or origin of capital equipment, usually for balance of payments reasons or to protect fledgling or even mature national industries. A *de facto* exclusion also may arise when the procedures to obtain import permits or licenses are exceedingly lengthy or costly or if customs duties are so high as to make import of such equipment too expensive when compared with a local or favored third-country alternative.

Such practices are well documented by a wide variety of U.S. manufacturers and need no elaboration here. Suffice it to say that U.S. export financing in general and the U.S. cross-border leasing business in particular suffer extensively from such limitations on free trade. The U.S. government should exert considerable pressure against offending governments to eliminate or at least minimize such practices.

As a side issue, it should be noted that such restrictions can be turned to the advantage of the U.S. cross-border lessor. By definition, a cross-border lessor holds title to leased equipment outside the lessee's country. In many cases, the foreign government can be persuaded in its own interest to permit the import of such equipment under cross-border lease financing, since it may not be counted in balance of payment or external debt calculations if the transaction is properly structured. The prospective lessee also may find that, because title to the equipment is held outside the country, it may be able to defer or even eliminate customs duties, which may be substantial.

• *Failure to accept ExImBank/FCIA/OPIC programs*—Assuming that ExImBank and/or the Foreign Credit Insurance Association (FCIA) eventually can develop a variety of lease programs which focus on broad parameters affecting their respective risks, foreign governments should and probably could be persuaded to accept the broad terms of such a program, as they have accepted similar loan financing, so long as the transaction accords with local law.

With respect to the Overseas Private Investment Corporation (OPIC), it should attempt to accelerate its negotiation and implementation of bilateral agreements between itself as an agency of the U.S. government and the various LDCs which it has targeted for assistance, inasmuch as the benefits of its lease program are unavailable in countries with which it has not concluded such as agreement. Also, U.S. lessors engaged in cross-border leasing may find such LDCs too small or otherwise too risky to warrant the investment of considerable funds in an occasional transaction. OPIC should seek appropriate changes in its enabling statutes permitting it to make lower cost funds available to such lessors than are otherwise attainable in usual capital markets. This would be accomplished either through its own resources or by subsidizing and/or issuing guarantees to the supplier of such funds, while at the same time allowing or perhaps guaranteeing the lessor that such transactions will return to it a better-than-average yield despite the reduced risks.

SUBSIDIARY OPERATIONS

• *Restrictive tax policies*—U.S. multinational leasing companies often want to make an intercompany loan to a foreign leasing subsidiary in order to insure adequate financial support for its present or projected level of local activity. They often may find that repayment of such loans, considered the *de facto* equivalent of an additional equity investment, will be subject to local withholding tax, thus indirectly making the local company's cost of funds higher. As a result, the U.S. multinational is less able to compete effectively with locally financed entities and the cost of equipment financing for local lessees is ultimately increased.

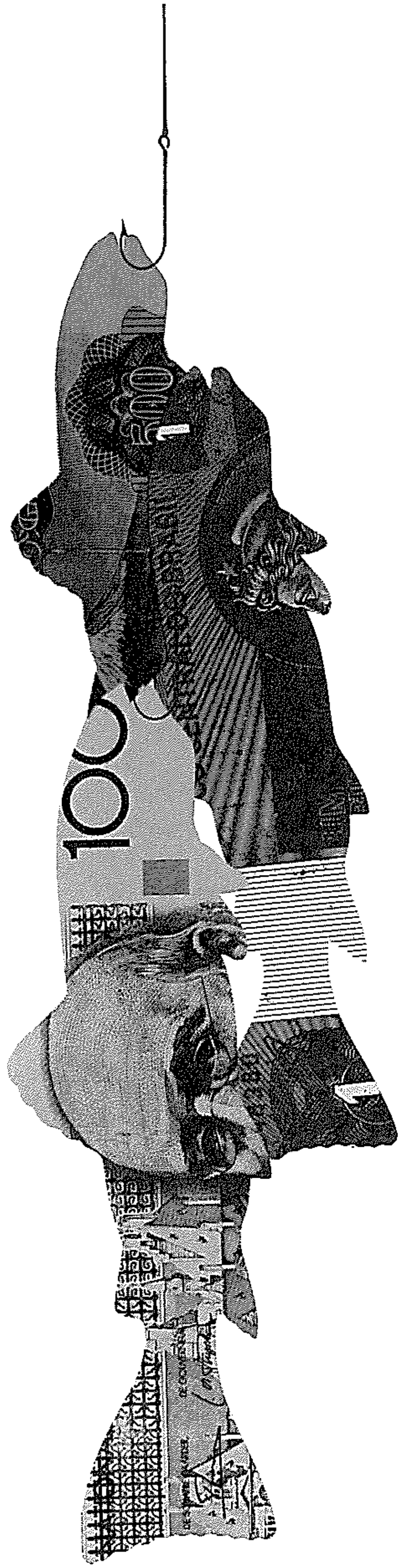
The leasing company may also find that it faces excessive taxation on foreign exchange operations or on remittances of normal dividends to its parent, thus reducing the value of the investment to the parent and inhibiting its future growth.

• *Restrictions on right of establishment and operations*—U.S. based leasing companies often may find that they may be excluded effectively from establishing a leasing subsidiary in a particular foreign market. Licenses to establish and operate a leasing subsidiary are often granted in an openly discriminatory or arbitrary process, or the process to obtain such a license may involve as much as several years of expense and waiting. In some countries the criteria for obtaining such a license, whether articulated officially or not, may be so narrow that they exclude all but a handful of persistent lessors.

The licensing process may also require that the prospective foreign investor be limited to a certain minority ownership position, reserving the balance of equity for local investors. While the existence of a local co-investor may be desirable under some circumstances, it can drastically slow down the development of the venture as a market force while the local partner educates its people, and can reduce considerably the value of the investment to the U.S. lessor by forcing it to share profits disproportionate to its considerable investment in funds and management. The U.S. lessor also may find itself with practical management and control problems. Local personnel supplied by the partner owe their ultimate allegiance elsewhere and may have management goals and investment objectives in mind which differ considerably from the U.S. investors. These conditions make it difficult, as well as inefficient, to effectively manage the company.

Such ownership restrictions generally are found in less-developed countries, especially in Latin America and more particularly in the Andean Pact countries. The restrictions usually have the avowed purposes of restricting control of the financial sector by foreign entities, forcing such entities to finance more than their respective share of the financial requirements of the entity through further injections of loan funds, and insuring the transfer of leasing expertise to a local financial entity. As a practical matter, such efforts usually seem to be counterproductive, as leasing expertise is freely available and local entrepreneurs usually have been able to set up and obtain funding for their own local entities. In any event, it is a restrictive practice which the U.S. government can and should work to eliminate.

Once the U.S.-owned leasing company is established locally, it may find that as a foreign company, it is restricted from financing certain industries or equipment reserved for local companies. It even may find itself limited in leasing activities involving the financing of capital equipment requirements for local subsidiaries of U.S. multinationals.



◆ *Financial restrictions*—Prior to commencement of local operations, the U.S. leasing company/investor may discover that local law mandates a debt/equity ratio either less advantageous than that permitted for local companies or simply inappropriate in light of the world-class nature of the U.S. investor and the financial strength it brings to the venture. It also may find when it seeks to satisfy its working capital needs that the terms of intercompany loans the parent may desire to make, or even the terms of loans to be made by third-party foreign financial institutions, may be the subject of inappropriate or restrictive legislation.

If a U.S.-owned leasing company does manage to arrange intercompany or third-party loans, usually in U.S. dollars, it may be severely restricted in its hedging activities, so necessary to protect from shifts in the value of the local currency. Such activities quite often are limited to hedging of the leasing company's registered capital only, leaving remaining hedging to be done outside the country, usually at considerable extra cost. If it seeks funding on the local market, it may find itself restricted as to the amount or nature of such borrowings, and quite frequently will find also that locally owned entities may be able to access preferential government-sponsored long-term low-rate funding from which it is excluded. If it turns to the public capital markets, it often will be severely restricted in its issuance of stock, debentures or other local debt instruments, while local companies may be freer to engage in these activities.

Once its sources of funds are in place, it may find that there exist severe restrictions on its power to declare and remit dividends to its parent. These may take the form of an explicit formula related to a percentage of its capital or yearly profits, or an implicit restriction through the use of a lengthy and required permit process. Even an outright prohibition against remittances of any such funds can occur if exchange controls are imposed.

If a prospective lessee is foreign-owned, there also may exist restrictions on a lessee's access to local currency financing. This sometimes is reserved for local companies, forcing the foreign-owned lessee to import its capital at a sometimes-higher expense and in a foreign currency.

All of these restrictions may place the foreign-owned leasing company in an extremely uncompetitive position vis-a-vis its local counterparts, undoubtedly slowing its growth as a vigorous source of local capital, and usually resulting in increased costs to the local lessee.

◆ *Limitations on import of capital equipment*—As in the cross-border area, local leasing companies may be unable to offer financing for imported equipment. If they can, they may find that import procedures are so cumbersome and lengthy and import duties so expensive, that they effectively are restricted from that market.

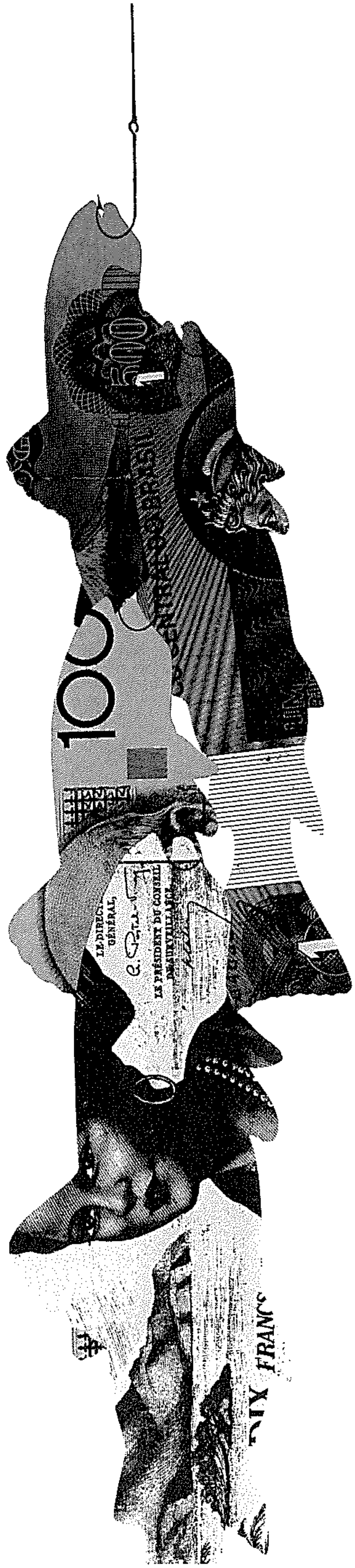
Recommendations

While there are no easy solutions to all these problems, the recommendations which follow can serve as the basis for a dialogue between the U.S. leasing industry and U.S. and foreign governments. Over time, such dialogue should improve the competitive position of the U.S. lessor abroad, maximize its attractiveness as an exportable service industry, and ultimately increase U.S. export of capital equipment.

(1) ExImBank, in cooperation with the U.S. leasing community, must develop and implement a simplified and flexible export credit and political risk insurance program for U.S.-manufactured capital goods leased to a foreign entity. Once developed, the program's terms and conditions, availability and premium cost should be published formally and made available to all U.S. vendors of capital equipment and U.S.-based lessors, their subsidiaries and affiliates. While a detailed analysis of such a program is beyond the scope of this presentation, the terms of such a policy issued thereunder should include as a minimum:

- A definition of the insured party to include foreign-incorporated lessors that are wholly or partly owned by a U.S. parent;
- Provisions permitting payments under a lease to be made in any currency, at any place designated by the lessor under the lease, and, as a corollary, perhaps offering or requiring currency risk coverage;
- Provisions permitting financing of 100% of the cost of the equipment;
- Provisions permitting a lessor and lessee to structure and negotiate a lease transaction which fits each of their respective needs and/or the requirements of local law, specifying only broad parameters (e.g., maximum and minimum lease term, minimum frequency of payments, nature of permitted end of lease options);
- Provisions providing for the use of such policy for both a one-time transaction as well as in a "master lease" situation (i.e., where a series of leases are covered under one master line of credit).

Such a program should be designed with a premium structure which is cost effective, so that the program pays for itself. Application and approval procedures should permit the use of the program in a timely fashion, at the point of sale if possible. Small transactions (e.g., under U.S. $100,000) would be approved automatically if certain credit and transactional criteria were met, whereas transactions of a larger size could be subject to graded levels of credit approval according to size. The most important administrative feature of such a program would be responsiveness: If a transaction takes more than thirty days to obtain coverage, the program would be useless. The lessee often will see financing as an integral part of its decision to acquire equipment and often can be expected to fulfill its equipment needs elsewhere if it cannot obtain rapidly a financing commitment.



(2) ExImBank must initiate a program permitting easier and more expeditious access to its resources by U.S. lessors involved in smaller-ticket cross-border leasing transactions. ExImBank traditionally has believed it to be more cost-effective to allocate its limited resources to fewer transactions involving big-ticket items such as aircraft. While the need for support of this kind of transaction is unquestioned, the much larger community of smaller-ticket capital equipment exporters virtually has been excluded from access to Bank funding. The Bank's policies in this area should be given careful scrutiny and possibly revised to allocate some of its resources to other significant portions of the export market.

It also seems clear that ExImBank's power to guarantee leasing transactions is largely unexplored, and the establishment of a program of various types of guarantees would serve to attract lower cost funds from the private sector to cross-border leasing transactions without draining ExImBank's available and severely limited cash resources. For example, ExImBank could issue guarantees covering the timely remittance of lease payments, cover debt associated with a leveraged lease, or even cover a minimum market or resale value of the equipment at the end of the original lease term (i.e., residual value guarantees). Each of these guarantees would have the immediate effect of making the ultimate cost of U.S. equipment less costly for lessees, would attract private-sector capital new to the leasing business, and would make possible a wider variety of lease transactions. Again, the program could be structured so that fees charged to the lessors would pay for the cost of the program itself and any losses incurred thereunder.

(3) A model tax treaty provision clearly spelling out the treatment to be accorded both cross-border financial leasing transactions and investments by U.S. multinational leasing companies in foreign leasing companies should be developed and implemented as soon as possible. The OECD recently has issued a report recommending the removal of withholding taxes on cross-border leasing transactions.[26] While the report is only a recommendation and covers only one aspect of the various tax matters affecting international leasing, it should serve as a point of departure when tax treaties are renegotiated among OECD countries. However, any such tax treaties, as well as others involving LDCs, should clarify *all* taxes and other payments applicable to cross-border leasing transactions, payments to be made thereunder and/or the equipment leased thereunder (e.g., withholding taxes, sales/value-added taxes, customs and import duties applicable to equipment leased under a cross-border lease, who is responsible for paying them and when, and in general, the tax treatment of all lease payments remitted from the lessee to the foreign lessor). In addition, the ability to remit dividends resulting from such foreign investments and the treatment of interest on intercompany loans made by a parent to such a venture also must be delineated clearly.

(4) The provisions of the Pickle bill and related legislation now pending before Congress, and likely to become law by the time this article appears, should be modified to permit U.S. lessors to again claim ITC and depreciation previously permitted under a lease of capital equipment, wherever manufactured, to a "foreign person," even though the income from the property is not subject to U.S. tax. As a fallback position, such an amendment could permit the use of U.S. tax incentives on cross-border leases of U.S.-manufactured equipment only. Either position would allow U.S. lessors to continue to lease transportation-related equipment, most of which is made in the U.S.

(5) The use of federal tax policy to motivate American business is only one of many tools available to the federal government and any changes must balance carefully the need for revenue against the anticipated benefits in the areas of domestic productivity and balance of payments. It may be debatable whether the policies our government seeks to further are appropriately accomplished through tax laws. However, given the fact that the U.S. domestic leasing business finds its strength and dynamic growth rooted in federal tax law, efforts should be made to find an acceptable package of tax incentives applicable to U.S.-made equipment leased abroad by U.S.-based lessors, which puts such transactions more nearly on a par with domestic leasing transactions vis-a-vis yield for the lessor.

The following are suggested, although by no means all-inclusive, proposals for change in federal law. The implementation of one or more of these would go far to encourage U.S. lessors to increase their current volume of international leasing business, increase U.S. exports and add to a more favorable balance of payments.

- *Alter present policy to make new U.S.-manufactured equipment, owned by a U.S. leasing company but leased abroad, eligible for all or some portion of tax incentives available inside the U.S.* Such a change in policy could be tailored to reach other objectives if desired (e.g., to encourage export sales of certain categories of industrial equipment). It also could be made applicable to certain large transactions lending themselves to cross-border leasing.

- *Pass legislation permitting U.S. leasing companies, owning all or part of a foreign leasing company, to take a credit against its overall U.S. tax liability or a deduction from its worldwide income of some percentage of the acquisition cost of all U.S.-manufactured capital equipment purchased by such foreign leasing company and leased to foreign lessees.*

- *Revise the existing tax law to permit "foreign source losses" generated by cross-border leasing transactions to be excluded from the calculation required by Section 904 of the IRC.* This would eliminate the effect of "foreign source losses" on the amount of foreign credits applied against U.S. tax liability.

(6) ExImBank should establish a division staffed with personnel knowledgeable in the leasing business. They should have overall responsibility for the development and implementation of export leasing programs, as well as the structuring and facilitation of transactions involving U.S. equipment exports and lease financing. Such a division also could serve as the repository of a centralized pool of information covering issues which are likely to arise in a contemplated foreign lease transaction, as well as a resource bank through which U.S. exporters could reach U.S.-based lessors operating in the foreign market to which equipment is being exported.

(7) The U.S. Commerce Department should undertake a country-by-country review of practices restricting entry to and fair competition in foreign leasing markets by U.S.-based lessors. The restrictions detailed herein are by no means all inclusive or even typical of any one country. An effort should be made to identify restrictions where they exist and persuade the government in question to modify, reduce or eliminate such restrictions.

The Future of International Leasing

The U.S.-based community of international lessors will be presented with numerous opportunities to extend operations and investment to a wide variety of foreign markets in the 1980s and beyond. The feasibility and attractiveness of such opportunities will depend in large part on an active and consistent policy of U.S. government support for U.S.-based international lessors, together with appropriate programs to facilitate the continued expansion of the industry.

Foreign governments must be persuaded to reduce or eliminate the constraints inhibiting the growth of leasing. The consequences of U.S. government support of the equipment leasing industry undoubtedly will be a more rapid expansion of existing activities, the entry of new U.S. lessors into more receptive foreign markets, a more favorable balance of payments and an increase in U.S. capital equipment exports.

Footnotes

1. Clark, T.M., Chief Executive, Lloyds International Leasing and former Chairman of Leaseurope cited in *Financing Capital Formation through Leasing: The IFC Experience*, International Finance Corporation. Capital Markets Department, Washington, D.C.

2. American Association of Equipment Lessors (AAEL).

3. Clark, T.M., "The Dawn of International Leasing," *The Banker*, Financed Times Business Publishing Limited, London, April 1982, pg. 57 et seq.

4. H.R. 3110, H.R. 4170 and S. 1564.

5. *World Leasing Yearbook 1984*, Hawkins Publishers Limited, London, 1984, pgs. 29 & 31.

6. AAEL informal survey, February, 1984.

7. Mexican Leasing Association (Organizacion Arrendamiento AC).

8. Venezuelan Leasing Association (Asociacion de Empresas de Arrendamiento Financiero).

9. *World Leasing Yearbook 1982*.

10. *World Leasing Yearbook 1984*.

11. Miyauchi, Yoshihiko, "A Rising Force in Asia," *The Banker*, London, May 1983, pgs. 117 et seq.

12. *World Leasing Yearbook 1983*. See also Curtin, Donald "Japan's Greatest Export Success Is Leasing," *Euromoney*, June, 1982.

13. Curtin, Donald. op. cit. supra.; Imokowa, Minoru, "Samurais Make Way for the Shogun," *Asian Banking*, May, 1983.

14. *World Leasing Yearbook 1983*.

15. Miyauchi, Yoshihiko, op. cit. supra.

16. Id.

17. Id.

18. Id.

19. Id.

20. International Finance Corporation, Washington, D.C.

21. For an analysis of the existing FCIA program, see Taylor, Lawrence M., Jr., "The Use of Export Credit Insurance in International Leasing: Recommendations for Improvement," paper presented to FCIA and ExImBank, December, 1982.

22. See, e.g., "Report of the Technical Subcommittee on Cover for Leasing," International Union of Credit and Investment Insurers, 1983, and "Arrangement on Guidelines for Officially Supported Export Credits," Organization for Economic Cooperation and Development (OECD), 1982. These "Berne Union Guidelines" and the "OECD Consensus," as each document is respectively referred to, have in their present form and as interpreted by ExImBank and FCIA been the major impediments to the development of a usable U.S. export leasing program.

23. U.S. Internal Revenue Code (IRC) Sec. 48(a)(2)(A).

24. IRC Sec. 48(a)(2)(B).

25. See, e.g., *Financing Capital Formation through Leasing: The IFC Experience*, International Finance Corporation, Capital Markets Department, Washington, D.C., May, 1981, and *IFC's Leasing Company Investments: One Year Later*, Id., October, 1982.

26. *Leasing Digest*, March, 1984.

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