



**Banking and Financial Services**

Finance Leasing



## Introduction

The Finance Leasing law (72(I)/2016 (the "Law") entered into force, in Cyprus, on 28 April 2016 with a further Financial Leasing Directive (the "Directive") issued by the Central Bank of Cyprus on 17 February 2017.

The purpose of this legislation is to provide a regulatory and supervisory framework for the operation of financial leasing companies providing leasing services to the public.

Currently, in Cyprus, a number of local Banks and private companies offer Finance Leasing services. The new directive by the Central Bank coupled with the new accounting requirements set by IFRS16 present a new challenge for organisations already operating in the leasing sector as well as for new entrants.

## The purpose of this publication

- Outline the regulatory and supervisory framework around financial leasing in Cyprus
- Explore the different types of permitted services and exclusions
- Identify the requirements for being granted a license by the Central Bank of Cyprus
- Provide an overview of how Deloitte can support its clients

## Definition

Financial Leasing is an alternative way of financing whereby a licensed leasing company (the "Lessor") purchases an asset on behalf of its customer (the "Lessee") in return for a contractually agreed series of payments which usually include an element of interest. The lessor maintains ownership of the asset while the lessee enjoys the use of the asset for the duration of the lease agreement, usually accompanied by an option to buy the asset at the end of the contract. The lessee bears all costs and risks associated with the use of the leased asset.

## Applications of the Law

Under the current rules, leasing services, in Cyprus, may be provided to the public by any of the following:

- Leasing companies registered in the Republic of Cyprus and licensed by the Central Bank of Cyprus for the provision of such services
- Credit institutions registered in the Republic of Cyprus and licensed by the Central Bank of Cyprus for the provision of leasing services
- Credit institutions registered in other EU/EEA member states and licensed by their respective regulatory authority for the provision of leasing services. These services can only be provided in Cyprus through a branch or on a cross-border basis
- Financial leasing companies which are subsidiaries of credit institutions registered in an EU/EEA member state and provide leasing services in Cyprus through a branch or on a cross-border basis

Financial leasing companies registered and operating in Cyprus may set up and operate branches and provide leasing services in other EU/EEA members states provided they meet the relevant regulatory requirements and obtain the consent of the Central Bank of Cyprus

The provision of leasing services without the necessary license is punishable by a fine of up to €200,000 and/or imprisonment of up to four years.

**The regulatory authority in Cyprus is the Central Bank of Cyprus.**

## Exclusions

According to section 3(2) of the Law, the following are exempt from the provisions of the Financial Leasing Law

- Financial leasing services not addressed to the public and include among others the provision of leasing services from legal entities exclusively to their holding or subsidiary companies, or to other subsidiaries of their own holding company
- Individuals or legal entities whose primary business activity is the sale of movable property and which provide leasing services for the sale of movable property up to the amount of €5,000 per asset, exclusively to the extent required for the exercise of their main business activities
- In cases where the lease has a duration of less than three months

## Permitted services

The following lease types may be provided:

- **Simple financial leasing**

A lease arrangement under which the lessee chooses the asset leased and the lessor buys and leases it to the lessee for an agreed series of payments

- **Hire-purchase**

A type of lease which gives the lessee (hirer) the option to purchase the asset. Ownership of the asset is transferred immediately after the last payment is made

- **Leveraged (Participatory) leasing**

A lease that is partially financed by the lessor through a third-party financial institution. The lending institution holds the title of the asset and the loan is serviced through the lease payments. The lessor collects the payments from the lessee.

- **Leaseback (Reverse leasing)**

A lease arrangement under which the lessee transfers the full ownership of the asset to the lessor and at the same time the lessor leases it back to the lessee

- **Joint (Syndicated) leasing**

A lease agreement between one lessee and multiple lessors, usually in cases where the cost of the asset is too high for a single lessor. This type of lease shares the same characteristics of a syndicated loan

- **Leasing with a sub-lease**

A lease agreement which between the original lessee and a new lessee. The new lessee enjoys the use of the asset for the duration of the sublease while the original lessee maintains the obligation to make the agreed payments and the right to buy the asset at the end of the contract

In cases where the asset falls in the category of immovable property, the lease duration must be at least ten years irrespective of any provisions to extend.

In addition to the above, the following services may also be provided by a financial leasing company:

- Operating leasing services
- Negotiation and purchase of movable or immovable property for the purpose of leasing or leaseback
- Maintenance and safekeeping services for leased assets and assets available for leasing
- Assignment of construction, maintenance and improvement works for buildings or premises, for leasing purposes
- Any other services specified by the Central Bank of Cyprus

## Key elements of leasing license

The Financial Leasing Law, and subsequent Central Bank Directive, set out the minimum requirements for the consideration of an application for the provision of leasing services.

- A report indicating the persons who hold or plan to hold a qualifying holding in the share capital of the leasing company or its twenty largest shareholders. A questionnaire for each shareholder should be appended to the report.
- For each of the members of the management team and senior management, a duly completed and signed questionnaire
- A detailed business plan, including a baseline and extreme scenario, which includes the budget for the first three financial years
- The applicant company must demonstrate that it will have adequate resources (financial and technical) to employ appropriate systems and procedures to ensure its sound operation. In addition, the company must show that it has an adequately skilled and trained employee base and a capable management team
- Calculation of the cost of investment (including methodology)
- Source of funds
- A description of the accounting system, the Information Technology system and the management information system to be employed
- A complaint handling procedure
- A description of the systems that will be implemented for the collection of statistical and supervisory data

- The internal control mechanisms for ensuring compliance with the requirements of the Prevention and Suppression of Money Laundering Activities Law of 2007 to 2016.

The above must be accompanied by a confirmation from an **independent audit firm** that the company has:

- The minimum initial capital required - Issued and paid share capital and retained earnings of the company is at least €200,000
- Any amount of additional capital required on the basis of the submitted business plan (as per the bands of minimum level of total capital in the following section)
- In the event that a shareholder does not wish to pay the necessary capital before the approval of the application, a confirmation letter must be submitted to the Central Bank from a credit institution, confirming that the relevant amount has been deposited and will remain blocked throughout the course of the application and evaluation process and that the company will be able to have the funds upon approval.

## Monitoring and supervision

### Registration of leases

The following leased asset types must be disclosed in the appropriate Government registers:

- Aircrafts – Cyprus Aircraft Register of the Department of Civil Aviation
- Motor vehicles – Central Register of the Road Transport Department
- Immovable property – Register of the Department of Land and Surveys

### Ongoing obligations

A financial leasing company must continue to comply with the following:

- Maintenance of minimum capital in line with the value of their assets as below:

Total level of assets	Minimum level of total capital
Up to €5m	€200,000
Over €5m and up to €25m	€1,000,000
Over €25m and up to €50m	€2,000,000
Over €50m	€5,000,000

- Submission of Balance sheet and Profit and loss within six months of the end of each financial year

In addition to the above, the following need to be adhered to:

- Any additional share capital should be issued in agreement with the Central Bank of Cyprus
- A reduction of share capital is not allowed, unless an approval certificate of the Central Bank of Cyprus is obtained
- In case the paid share capital falls below the minimum threshold of €200,000, then the Central Bank will not renew the institutions license

The license can be revoked by the Central Bank of Cyprus in case of violations.

### Termination of a lease

A financial lease is terminated when:

- The contract concludes and the lessee does not exercise his/her right to extend the lease or purchase the asset
- The lessee exercises his/her right to purchase the leased asset
- The payment obligations are not met by the lessee (subject to the clauses of the contract and adherence to local law)
- Any of the clauses stipulated in the lease agreement are violated by either party

## Tax Considerations

### Direct Tax

The basic premise for assessing the Direct Tax implications of entering into Finance Leasing transactions is that the standard rules apply.

Depending on the type of asset subject to Finance Leasing, special rules may apply. Examples include immovable property whereby:

- Lease payments payable in respect of a financial lease, with the right of purchase of the property by the lessee, do not constitute rent and are therefore not subject to special contribution for defence
- Simple financial leasing and reverse financial leasing are generally exempt from capital gains tax

Advice therefore needs to be sought before entering into such trading activities. Our Direct Tax experts can help you structure your affairs and advise you on how best to address any tax implications.

### Indirect Tax

The activities of all finance leasing companies registered under the above mentioned legislation, are subject to VAT.

As with Direct Taxation, advice should be sought in each case depending on the type of assets subject to Finance Leasing. Our VAT Specialists should be able to advise you on the VAT implications of such activities.

## How Deloitte can help you

Our experienced team of leasing experts can support your organisation through:

### Regulatory compliance

- Assisting you in all stages of **setting up** of your of your financial leasing entity
- Preparation and submission of your application for authorisation by the Central Bank of Cyprus (incl. Business Plan preparation and estimation of Cost of Investment)
- Liaising with the relevant authorities to ensure license evaluation and granting
- Governance – designing and implementing a Directives compliant framework for your organisation in order to obtain the necessary licensing
- Policies and procedures – designing of a functional operating model and supporting processes and procedures (including AML and Complaints' handling process)
- Evaluation of Board members and Senior Management
- Provision of independent assurance services to confirm the requirements of the Central Bank of Cyprus in regards to:
- Minimum initial capital requirements
- Any additional capital requirements as defined in Article 6 (2) of the Leasing Law of 2016
- Presence of necessary blocked funds and initial capital for the purposes of the evaluation of the application

### Legal contracts' review

- Our Deloitte Legal team can review or even draft your contracts including, among others, lease terms, renewal options and payment terms

### Accounting and Financial Reporting

- Review and determine whether the new Finance Leasing law and legal contract clauses may create accounting classification constraints under the relevant IFRS Standards: IAS 37 and the new IFRS 16 (for which a separate publication has been prepared by Deloitte and its published on our website).
- Advice on accounting implications of new Finance Leasing law on your company's Financial Statements and covenants

### IT Systems and Data

- Advisory services on accounting and operating systems' required for the acquisition of licensing for the provision of Leasing services
- Assisting with installation and maintenance of software

### Tax

- Tax structuring – advising you in your tax planning and compliance both for Direct and Indirect tax matters

### Training

- Role specific training
- Finance or non-finance staff
- Business or accounting oriented

# Contacts

If you require any further information on any of the issues mentioned in this material and on how Deloitte can help you address the challenges ahead, please do not hesitate to contact



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