

Leasing in Brazil

History and background

The first goods subject to lease agreement in Brazil were in fact typewriters. This expanded to contracts governing machinery among different groups within industry and later (around 1970) to national and international financial institutions.

According to the Brazilian Association of Leasing Companies (ABEL), leasing operations in Brazil reached R\$ 9,5 billion (approximately US\$5,6 million) in 1999; a notable decrease in comparison to the R\$15,5 billion (approximately US\$9,2 million) of the previous year. The reason for such decline can be found in the unstable economic period that affected the country in the beginning of last year. The devaluation of the Brazilian currency (Real), the increase in bank interest rates and consequent decline of various industrial activities, meant that leasing operations became financially less attractive within production and industry sectors.

Since many lease contract signed before the economic crisis of January 1999 were indexed in American Dollars (exchange indexing is generally forbidden in Brazil and only accepted - in the case of leasing - when the goods were acquired with the use of loans contracted directly or indirectly abroad), lessees suddenly found themselves unable to fulfil their payment obligations. Giving rise to a great number of lawsuits.

Fortunately the Brazilian economy has enjoyed a significant resurgence since the beginning of this year in all industrial and market sectors. With the economy once again stable the number of leasing operations has increased correspondingly. For the first 4 months of the year 2000 ABEL reported an increase of 90% (corresponding to US\$ 1,3 billion dollars) in the leasing sector comparing to the same period in 1999. In May of this year, 32,500 new lease contracts were signed, 7% more than in April. It is expected that by the end of this year the leasing operations will reach US\$ 10 billion.

Vehicles and related products are currently responsible for 80% of the total leased goods in Brazil. Nowadays machinery and equipment make up only 5,8% of leased goods, while computers and equipment account for 7,3% of the leasing operations. Considering that foreign investment in Brazil is once again increasing. ABEL expects that the rate of machinery leasing should also rapidly increase.

Another interesting fact refers to the activity sector in which leasing operations have been concluded. According to the most recent information given by ABEL almost 40% of lease contracts in Brazil are entered into with individuals. Approximately 25% are in services and only 8% in industry.

At the World Leasing Convention in Dublin last May Brazil was ranked as the seventh largest country in terms of leasing operations (US\$ 13,3 billion). Germany is third with US\$37 billion followed by England (US\$20 billion). Germany is third with US\$ 37 billion followed by England (US\$20 billion), France (US\$18 billion) and Italy (US\$13,6 billion).

Brazil has currently more than 70 leasing companies and some multiples banks also hold a leasing portfolio. These companies are regulated by the Central Bank of Brazil.

Legislation and general conditions of leasing

Law nr. 6.099 of 1974 regulates leasing in Brazil. Leasing operations are also subject to the Resolutions of the Central Bank of Brazil and the standards of the National Monetary Council.

According to Brazilian law, commercial lease is deemed to be an operation carried out between a legal entity, as lessor, and a legal natural entity, as lessee, for the purpose of leasing of goods acquired from third parties by the lessor for use by the lessee and pursuant to the latter's specifications.

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During the lease agreement the lessor remains the owner of the leased goods, the lessee only having the right to use it for the purposes and term established by the parties. Upon termination of the contract, the lessee may have the option to purchase the goods, return the goods to the lessor or, as the case may be, extend the lease.

Generally the lessee can be either an individual or a legal entity. The lessor however cannot be an individual but merely (i) legal entities that have as the primary object of their activities the carrying out of leasing operations; (ii) multiple banks with leasing portfolios and (iii) financial institutions authorised to contract leasing operations.

Legal entities that have commercial leasing operations as the primary object of their activities should have a constitution and operations, which correspond to those of a corporation their legal form, and they depend the Central Bank of Brazil for authorisation. The Central Bank of Brazil is in charge of the inspection and control of all commercial leasing operations.

The goods that may be covered by leasing operations are foreign or nationally produced movables (machinery, equipment, vehicles, etc) and immovables. The law asserts, however, limitation on foreign goods, which may only be subject to lease operations if listed by the National Monetary Council in Brazil. The National Monetary Council may also establish conditions on leasing to companies whose stock control is held by foreign residents.

In order to be classified as a leasing operation, a lease agreement shall contain the following conditions according to the Brazilian legislation:

1. description of the goods subject to the contract;
2. the term of the leasing operation (depending on the type of leasing);
3. the value of each instalment and the formula for calculating the instalments, as well as the criteria for adjusting same;
4. the set periods in which the instalments are due, not to exceed 1 semester, except in the case of operations that benefit rural activities, in which case payment may be set for periods of not more than 1 year;
5. the conditions under which the lessee may exercise the right to opt for contract renewal, return of the items or acquisition of the leased goods;
6. granting to the lessee of the option to purchase the leased goods, together with the specified price or exercising that option or criteria to be utilised in setting that price;
7. additional expenditures and charges, including outlay on technical assistance, maintenance and services essential to the operational aspects of the leased goods.

8. Without the conditions above, the operation may not be deemed as a leasing agreement and therefore will not profit from the tax advantages for leasing determined by the National Financial System.

Types of Leasing in Brazil

Brazil recognises mainly two types of leasing: financial and operational leasing.

Financial Leasing

Financial leasing operations constitute the majority of lease agreements and are classified as agreements in which:

1. The instalments and other payments specified in the contract and due by the lessee are normally sufficient for the lessor to recover the cost of the leased good during the contractual period of the operation and, additionally, obtain a return on the resources invested;
2. expenses on maintenance, technical assistance and services related to operational aspects of the item leased are the responsibility of the lessee;
3. the price for exercising the purchase option is freely negotiated and may also be the market value of the leased item.
4. The duration of a financial lease contract is determined in relation to the type of goods, but should not be less than 24 months. Another characteristic of this type of leasing is that the lessor must purchase the goods in accordance with the exact description given by the lessee.

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I. Lease-back

Lease-back is another type of financial lease defined as being an operation in which the seller of the goods leases it back after selling it to the purchaser. In Brazil, this operation may only be carried out between legal entities. Particular conditions are set down for this type of leasing:

1. only machinery and equipment can be the object of a lease-back agreement;
2. the minimum term is 8 years;
3. the price of the contract shall not exceed 75% of the cost of the leased goods, including financial charges;
4. when terminated the contract the lessee may have the right to repurchase the goods;
5. expenses on maintenance, insurance and tax burden are the responsibility of the seller-lessee.

II. Real estate leasing

Real estate leasing is also classified as being a financial leasing. Normally the constructions of a building or the building itself are the subject of the lease. According to Brazilian law, real estate leasing agreements must be registered at a real estate registration office in order to be valid against third party claims.

III. Subleasing

Another type of financial leasing is sub-leasing. Sub-leasing involves lease operations by companies registered in Brazil with entities registered abroad for the exclusive purpose of subsequent subleasing of goods to legal entities in Brazil. Such operation is subject to registration at the Central Bank of Brazil. The expenses and costs of subleasing are transferred to the sub-lessee based in Brazil and will be incorporated into the cost of the leased goods.

Operational leasing

Operational leasing, commonly used for the lease of airplanes, consists of the following:

1. compensation to be paid by the lessee cover the cost of leasing the goods and services required to make the goods available to the lessee, and the present value of payments does not exceed 90% of the cost of the goods;
2. the agreed term does not exceed 75% of the economic life of the goods;
3. the price for exercising the right of purchase is the market value of the goods leased;
4. there is no guaranteed payment foreseen for the scrap value of the goods;
5. maintenance technical assistance and services related to operation of the leased goods may fall under the responsibility either of the lessee or of the lessor.

In contrast to financial leasing. Operational leasing has a minimum duration of only 90 days.

International Leasing

a) Background

Until the end of the 1980s, leasing operations between entities domiciled abroad and lessees of goods in Brazil were restricted to airplanes. Today the situation is different. International leasing is competing with domestic operations in many different market sectors, such as communication, electricity, infrastructure, transportation and medical equipment.

Companies in Brazil are choosing to lease their machinery from others companies abroad because taxes levied on international financing are less than those within Brazil. International leasing can represent 3% to 4% less tax a year for a company choosing to lease abroad. For example, machinery or equipment worth US\$ 5 million would have a tax burden of 15% to 16% a year in a domestic lease operation, whereas the same goods in an international operation would have a burden of no higher than 12%.

Another advantage of international leasing lies in the term of the operation. In Brazil, a domestic leasing may not last more than three years, whereas international contracts may provide for a longer period for the lease operations.

b) Legal aspects of the international lease operation

According to the Brazilian law, all lease agreements entered into with entities domiciled abroad shall be subject to filing with the Central Bank for approval. If the lease good is to be imported, the lessee or the importer should also proceed with the correspondingly import clearance. These two steps for ap-

proving the operation is normally done by special companies in Brazil called "Despachantes Aduaneiros" (customs broker) and takes 15 to 20 days (before 1997 would take more than 120).

As with domestic leasing, imported new and used capital goods, movable and immovable goods may be included in leasing operations carried out with a lessor domiciled abroad, under due observance of norms governing import operations. There are, however, some restrictions, mainly with regard to the leasing of real estate. The Central Bank of Brazil does not approve, for instance, the construction of building by a company established abroad if it is intended to lease the building. Such companies are only allowed to lease buildings in Brazil, which are already constructed.

The Central Bank of Brazil will consider the following aspects when approving the international leasing:

1. reasonability of the instalments and their structure;
2. criterion for the establishment of the life of the good;
3. consistency between the good's lease term and its life;
4. relationship between the international price for the good and the total cost of the commercial lease;
5. purchase option clause or contract renewal clause;
6. other warranties dictated by national economic and financial policy.

International leasing may also be either financial or operational. In a financial leasing, a lessor domiciled abroad purchases goods in order to lease them to a client in Brazil. If the lease goods are imported, the importer will be the lessee himself and will be responsible for all costs, taxes, insurance and transportation arising from the importation of the goods. Lease-back are also common within international lease operations. A lessor abroad purchases goods first owned by a lessee in Brazil and leases it back to a lessee-seller. Such agreements provide companies with more working capital.

The minimum periods required for an international leasing are (i) 2 years or (ii) 3 years in all other cases.

IV. Restrictions

Brazilian law prohibits in general the practice of self-lease. Leasing companies and financial institutions are not permitted to contract leasing operations to associated or interdependent individuals and legal entities, managers or those entities, their respective spouses or close relatives nor with the manufacturer of the leased goods. An associate or interdependent person is defined as an entity:

1. in which the lessor entity participates directly or indirectly with a holding of 10% or more of the capital;
2. in which the managers of the lessor entity, their spouses or close relatives directly or indirectly participate either jointly or separately with a holding of 10% or more of the capital;
3. in which the stockholders with a holding of 10% or more of the capital of the lessor entity directly or indirectly participate with a holding of 10% or more of the capital;
4. which directly or indirectly participates with a holding of 10% or more of the capital of the lessor entity;
5. in which the managers, their spouses or close relatives directly or indirectly participate either jointly or individually with a holding of 10% or more of the capital of the lessor entity;

6. in which the partners, quota holders or stockholders with a holding of 10% or more of the capital also directly or indirectly participate with a holding of 10% or more of the capital of the lessor entity;
7. in which the managers are wholly or partially the same managers as those of the lessor entity.

V. Tax advantages of lease operations

Leasing operations receive special tax treatment, increasing their appeal to many companies.

In Brazil, the instalments paid or credited pursuant to the commercial lease agreement are deemed the lessee's operating costs or expenses and can therefore be deducted from the lessee's income tax.

Another tax advantage arises from the fact the goods under to commercial lease are ledgered under a special fixed assets account in a lessor's accounts and therefore do not need to be included when calculating income tax of the lessee's company.

In the event the lessee exercises their purchase option, the goods will be integrated into the lessee's acquirer's fixed assets at the purchase price.

VI. Consumer Rights - CDC

An important issue when analysing leasing operations in which the lessee is domiciled in Brazil is consumer rights. Brazil has a specific code protecting the consumer who can either be an individual or a legal entity. The terms this legislation apply whenever the commercial relationship between the parties creates an unequal situation among them so that one party, in a consumer relationship, will be advantaged.

Because banks and other financial institutions normally occupy a more powerful contractual position, agreements entered into with these are subject to the code of consumer rights, Lease operations are no exception to this. A very recent example occurred after the Brazilian currency devaluation in January 1999. At that time those who had entered into a contract with an exchange indexing clause (American dollar) ended up having to pay the instalments at double the price originally agreed, After many lawsuits most Brazilian Courts agreed that because the lessees were suddenly put in a very week situation, caused by a economic instability, they should have the right to negotiate another and more favorable indexing clause with their respective lessors. This decision was made in accordance to the terms of the Code of Consumer Rights.

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