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The Effect of the Amendments to the Tax Laws of Financial Leasing on Capital Budgeting Decisions

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For the financial leasing operations in Turkey, the article 290 was added to Tax Procedural Law with the article 25 of the Law 4842. Through this article, new rules have been put for the financial leasing operations as of 01.07.2003. The Ministry of Finance published this Law in the Tax Procedural Law General Announcement numbered 319 and Accounting System Implementation General Announcement numbered 11.

Financial leasing operation is defined in the article 290 added to Tax Procedural Law No. 213 as " irrespective of the fact that right of ownership is transferred to the lease-holder at the end of the leasing period, it is the leasing activities with the risks and benefits stemming from the ownership of an economic asset"

In the regulation stated above, what activities count leasing activities are stated. As such, the following activities count as leasing

a) The transfer of the ownership of the economic asset at the end of the lease period

b) Right to the lease-holder to purchase the economic asset at a price lower than the market value

c) The period of leasing covering more than 80% of the economic life of an asset

d) The total value of the leasing payment for the economic asset higher than 90% of the market value by the contract

In the new regulation published, as of 01.07.2003, the application of recording the leasing fees as expense in the period of invoice is no longer possible for the leasing operations that was performed following the given date in accordance with the article 90 of Tax Procedural Law

Instead of this, the total debt from the financial leasing is separated by the lease-holder as the right for ownership and the cost of financial leasing loan. Contrary to the previous implementation, following the Law No. 4842, during the invoice period of the expense of financial leasing, the implementation of recording this as direct expense end and instead of this the cost of loan is recorded as expense.

With the new regulation, whether an investment through financial leasing before and after the regulation is economical or not has been dealt with the following example

In the example under consideration, a machine will be acquired with 5 years of economical life and the investment expense 100.000 TL, using financial leasing. İt is estimated that the first sale that will be performed using the machine will be 62.500 TL. ıt is expected that the sale income will increase by 10 each year. The payments of the financial leasing are the 60% of the sale income. The interest rate of the financial leasing is 10% annually and the payments for leasing will be in 10 equal instalments. The corporate tax rate for the firm is 20% and the equity cost is 12%. There will be no additional loan in the following years. In the event that leasing payments are completed within 2 years, the free cash flows to equity have been calculated separately considering pre and post-tax regulation. The net present value of the investment for the shareholders became higher in the pre-tax regulation period.

If the leasing is completed within 5 years, the net value calculated is lower in the pre-tax regulation period.

In sum, the tax regulation performed in 2003 has affected the investment decisions of the firms in financial leasing. The new regulation has a negative effect for the firms completing their payments in short terms, while it has a positive effect for the firms that will pay lease in the economic life of the asset leased or in the long term.