D17 Leasing – Solutions

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Leasing is similar in meaning to “let” or “rent.” The lessor provides the lessee with the use of a movable good or real estate object for a certain period of time, for which the lessee has to pay a fee (lease payment). Ownership of the leased object does not pass to the lessee.
Unlike other contracts that govern the transfer of usage (such as is the case with a rental contract), the lessee bears the risk of accidental loss or deterioration of the leased property. Even in the event that the leased good is completely destroyed, the lessee must continue to pay the lease payments. It is the responsibility of the lessee to maintain and insure the leased good as well as cover any necessary repairs.
In Switzerland, leases are considered among the so-called innominate contracts, which are not regulated as such by the law. However, they generally contain elements of purchase, hire-purchase, rent and possibly other contracts, which is why they are legally considered mixed contracts.

2

a The finance lease is characterized by the following characteristics:

- The lessee seeks the long-term usage of a usually very capital-intensive investment good and seeks long-term financing.
- Existence of a triangular relationship (→ indirect leasing).
- The contract is characterized by a long, non-cancellable contract period (usually 3–5 years).
- During the term of the contract, 80–100% amortization of the leased object is often sought, based on regular (usually monthly) payment of lease terms.

The operating lease can be characterized as follows:

- The leased good is either cancellable at any time or usage can be transferred during the term for a short, non-cancellable period.
- The purpose is to cover only short-term demand for use of an asset by the lessee.
- In this type of lease, the leased asset is not yet fully amortized at the end of the contract – the lessor must therefore be able to use it again (e.g., sell it again).
- Due to the similarity with tenancy conditions, the operating lease may be classified as ordinary rent.

b Sale-and-leaseback:

- The lessee sells equipment and real estate at a cash price to a leasing company and immediately leases the same back.
- In this form of leasing, no third party is involved in the contractual relationship – so it is a pure two-party relationship between the lessee and lessor.
- Purpose: This leasing option is often used to overcome liquidity bottlenecks: The enterprise receives from this sale of equipment or real estate needed liquid assets without having to give up usage.

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- This involves direct leasing. With the direct lease, the lessee leases the leased good (or leased property) directly from the manufacturer (lessor), and owes lease payments to the lessor for the leased good. In practice, this basic type of direct leasing business is of relatively minor importance.
- In contrast, indirect leasing is characterized by the presence of a triangular relationship: The lessee selects the desired leased object from the manufacturer/supplier. However, in this case, it is not the manufacturer/supplier itself but a leasing company or bank that acts as the lessor. This party will acquire the leased object from the manufacturer/supplier and transfer the right to use it to the lessee under the conditions of a lease contract.

4

Leased assets such as production facilities do not become the property of the lessee. In the event of a decline in order volumes or sudden liquidity needs, there is no possibility of selling the leased asset. As particularly the finance lease is characterized by a long and non-cancellable contract period, capital remains bound up in it for a long time, regardless of any excess capacity. If an asset is not purchased and only the right to usage has been transferred, as is the case in leasing, then any right to dispose of the asset is greatly restricted – and thus, so is flexibility.

5

Advantages of leasing over buying on credit or using equity financing:

- No equity is tied up in the good
- Liquidity is maintained – instead of a large one-time liquidity outflow, there is an ongoing, much smaller outflow over time.
- Tax advantages as payments can be deducted as a business expense (under certain conditions).
- The lessee doesn’t have to include leased goods on the balance sheet – under Swiss OR, all that is required is a simple declaration attached to the annual report. Recommendations of the Swiss Foundation for Accounting and Reporting are not legally binding. To this extent, leasing can therefore be structured in such a way as to be balance-neutral.
- Leasing costs are incurred along with the use of the leased object. Financial inputs are not necessary, since the object constantly funds itself ("pay as you earn" effect/cost congruence).
- Disposal of the leased object at the end of the contract does not apply because it is returned to the lessor (unless there is purchase stipulation in the contract).

Disadvantages of leasing over buying on credit or using equity financing:

- The lessee does not acquire ownership of the leased object and therefore does not the right to sell it in the case of excess capacity or urgent cash requirements.
- The total cost of leasing, considering the entire period of use, is usually higher than using debt to purchase an object, because the lessor must calculate default risk (the risk that the lessee can no longer meet its obligations) and also expects a profit.
- The lessee must continue to pay lease payments even in the case of the accidental destruction of the leased object or even if he has no use for it.
- In the case of legal disputes relating to guarantee and warranty in a situation with indirect leasing, claims must be asserted to the manufacturer/supplier, as the lessor generally contractually cedes these claims to the lessee. This means that the lessee will have to pursue on his own the rights the lessor (the leasing company, for example) would have against the manufacturer/supplier on the basis of the purchase agreement.

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