

TECHNICAL ADVISORY

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Technical Paper:	<i>GENERAL CONSUMPTION TAX TREATMENT OF LEASES</i>

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Abbreviations and Glossary of Terms

Commissioner General	Commissioner General, Tax Administration Jamaica.
Lessor	The person that earns revenue by leasing a non-current asset to a lessee.
Lessee	The person that pays a lease fee to a lessor for the use of a non-current asset.
Operating Lease	A leasing arrangement between the lessor and the lessee where the lease fee incurred by the lessee is primarily a rental charge for temporary use of a non-current asset for which the risks and rewards incidental to ownership of the asset are not transferred to the lessee and for which the indicators as outlined below for a finance lease, do not apply.
Finance Lease	A lease arrangement in which the risks and rewards incidental to ownership of an asset are substantially transferred to the lessee. The Commissioner General may treat the following situations as an indicator that there is a finance lease: 1. The lessor transfers ownership of the asset to the lessee by the end of the lease term. 2. The lessee has an option to purchase the asset at a price less than fair value. 3. The lease term is at least 75% of the economic life of the asset, even if title is not transferred. 4. At the inception of the lease, the present value of the minimum lease payments amounts to at least 90% of the fair value of the leased asset. 5. The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made. If any one of the situations in 1-5 applies, the lease may be treated as a finance lease for tax purposes Other considerations that may influence the determination are:

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	• If the lessee is entitled to cancel the lease and the lessor's losses associated with the cancellation are borne by the lessee. • Gains or losses from fluctuations in the residual value of the asset accrue to the lessee (for example, as a rebate of lease payments). • The lessee has the option to continue to lease for a secondary period at a rent that is substantially lower than market rent.
IAS 17	The International Accounting Standard for leasing that was in effect prior to IFRS 16. Specific aspects of this Standard will be adopted for tax purposes.
IFRS 16	The International Financial Reporting Standard for leasing which took effect on January 1, 2019 but will not be adopted by Tax Administration Jamaica for tax purposes.
GCTA	The General Consumption Tax Act
GCTR	The General Consumption Tax Regulations
IROC	The Interpretation, Rulings and Opinions Committee
ITC	Input Tax Credit
Rewards	Include the right to use the non-current asset for most or all of its economic life, the profits to be gained from using the asset, as well as any appreciation in its value or residual value
Risks	Include the possibility of losses due to technological obsolescence, idle capacity and variations in returns due to changing economic conditions as well as responding to those risks by insuring, maintaining and repairing the non-current asset.

Purpose

The purpose of this Technical Advisory is to explain how leases should be treated for General Consumption Tax purposes by both lessors and lessees.

Background

Traditionally, there have been two types of leases: operating leases and finance leases which have always been accounted for differently.

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However, there has been uncertainty about how leases, especially finance leases, should be treated for General Consumption Tax purposes. Consequently, some taxpayers resorted to using Income Tax Circular 5/94 for guidance; so that, the entire lease fee for both types of leases was treated by them as a rental fee for hiring the asset and thus subject to GCT.

In this Technical Advisory, a distinction has been made between the two types of leases and their treatment for GCT purposes prescribed accordingly.

Introduction

Notwithstanding the accounting guidelines in IFRS 16 for the treatment of leases, it shall be the responsibility of the lessor at the inception of the lease period, by mutual contractual agreement with the lessee, to classify the lease arrangement as either an operating lease or a finance lease and shall accordingly determine whether the lease fee chargeable is subject to GCT.

Determination of Lease Contract

The CG may make a determination whether a lease contract is subject to GCT where the following circumstances arise:

- a. The contracting parties are unable to reach a mutually agreed position;
- b. The mutual contractual agreement is inconsistent with the accounting standard and practice acceptable to TAJ for GCT purposes;
- c. The lessor and the lessee are connected persons in accordance with section 2 of the ITA.

Guiding Principles

I. Operating Lease

- 1.1 Where the leasing arrangement is an operating lease, the entire lease fee charged by the lessor shall be subject to GCT and accounted for as such on the lessor's GCT Return.
- 1.2 The tax charged on the lease fee shall be deductible as an input tax credit (ITC) by the lessee in accordance with the provisions of GCT Regulation 14 where the lessee is a registered taxpayer for GCT purposes. For example, in the case of real property,

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intangible assets and machinery or equipment (except motor cars such as Station Waggon, Estate Car, Range Rover, Jeep or Pathfinder¹); the ITC in respect of the tax imposed on the lease fee shall be based on the tax stated on the tax invoice issued to the lessee. However, for the motor cars of the type mentioned above, only 50% of the tax charged on the lease fee is claimable in accordance with GCTR 14 (5)(a)(iv).

Where the lessee is not a registered taxpayer, the full amount paid in respect of the lease fee is deductible for income tax purposes.

II. Finance Lease

Where the leasing arrangement is a finance lease, its treatment for GCT purposes will depend on whether the leased asset was acquired from the vendor in the lessee's or lessor's name.

a. Leased Assets Purchased in the Lessee's Name

Guiding Principle

2.0 Where under a finance lease, the leased asset is purchased in the lessee's name, the transaction shall be treated as if a loan has been made by the lessor to the lessee to acquire the asset.

2.1 Therefore, in accordance with paragraph 23 in Part II of the Third Schedule to the GCT Act, the lease fee charged in a finance lease shall **not** be subject to GCT. It shall be appropriately split (in the accounting records) between the loan principal repayable by the lessee and the interest charged on the said loan to acquire the asset for the lessee.

Consequently, if the lessor also conducts a taxable activity and is a registered taxpayer, the interest portion should be recorded on the lessor's GCT return each taxable period as the value for the exempt supply of the loan to the lessee.

2.2 Furthermore, where there is a tax invoice to substantiate that the asset was acquired in the lessee's name, the lessee shall be allowed an input tax credit in accordance with the provisions outlined in GCTR 14 since a separate supply of a non-current asset would have been made by the vendor to the lessee. In which case, the ITC should be based on a cost not exceeding the cash price at which the vendor would have sold the asset in a transaction between unconnected parties.

¹ GCTR 14 (5)(b)(i)

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- 2.3 In this situation, the output tax imposed on the supply of the asset (to the lessee) is to be accounted for by the vendor.

b. Leased Assets purchased in the Lessor's Name

Guiding Principle

- 2.4 Where under a finance lease, the leased asset is purchased in the lessor's name, the transaction shall be treated as if the asset is being sold by the lessor to the lessee at the time when the non-current asset is made available to the lessee at the inception of the lease period.
- 2.5 However, the periodic finance lease fee charged throughout the lease term shall be treated as being exempt from the charge to tax. This also applies to lump sum lease payments to the extent that lump sum is accumulated principal repayment and interest charges due under the lease.
- 2.6 Where there is a tax invoice to substantiate that the asset was acquired from the vendor in the lessor's name, the lessor shall be allowed an input tax credit in accordance with the provisions stipulated in GCTR 14. Therefore, the ITC should be based on a cost not exceeding the cash price at which the vendor would have sold the asset to an unconnected party.
- 2.7 In addition to claiming an input tax credit, the lessor shall also account for output tax in the taxable period when the asset is made available to the lessee (section 6 (2), GCTA).
- 2.8 The value on which the output tax is to be computed by the lessor shall be the amount on which the interest rate was applied to derive the aggregate minimum lease payments required from the lessee over the term of the contract. If the interest rate implicit in the aggregate minimum lease payments cannot be readily determined to arrive at the value of the supply, the cash price at which the asset would have been sold in an unconnected party transaction shall be used.
- 2.9 Where a financial arrangement is said to be a lease but does not fall within the scope of a Finance or Operating lease as outlined above, the applicable GCT treatment will be determined based on the details of the arrangement. In such cases, consideration will be given to the legal intent as well as the substance of the arrangement.
- 3.0 In a finance lease arrangement, where ownership of the asset is passed, the burden of wear and tear also passes.

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Effective Date

The effective date for the revised treatment of leases for GCT purposes is **January 1, 2023**

New Lease Arrangements

The revised treatment in this Technical Advisory shall apply to lease arrangements which come into effect on or after **January 1, 2023**.

Existing Lease Arrangements

Lease arrangements which came into effect prior to January 1, 2023 will continue to be treated for GCT purposes in accordance with the rules which existed at the time of their inception.

However, in cases where the lease arrangements for the same asset have been renewed on or after January 1, 2023; the extended period commencing on or after January 1, 2023 will be treated as a **NEW** lease arrangement for the purposes of GCT. Consequently, the guiding principles in this advisory will apply to the extended period of the lease.

Conclusion

The appropriate treatment of a lease for General Consumption Tax purposes depends primarily on whether the leasing arrangement is that of a finance lease or an operating lease.

The lease fee charged under a finance lease is not subject to GCT because it represents a repayment of loan principal and interest. However, the lease fee payable under an operating lease is in effect a rental charge for hiring an asset and therefore subject to GCT.

The GCT treatment for finance leases is also dependent on whether the leased asset was purchased from the vendor in the name of the lessor or lessee, as evidenced by the supporting tax invoice. In which case, the purchaser (the lessor or lessee, as the case may be) will be entitled to an input tax credit in accordance with the rules laid down in GCTR 14.