

Volume 23 Issue 3

**INVESTMENT IN POST-PANDEMIC UGANDA: REFORMING FINANCE LEASING FOR CAPITAL FORMATION**

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**RECOMMENDED CITATION:** Kabazzi Maurice Lwanga (2021) “Investment in Post-pandemic Uganda: Reforming Finance Leasing for Capital Formation” Volume 23 Issue 3, Makerere Law Journal pp 462-492

# INVESTMENT IN POST-PANDEMIC UGANDA: REFORMING FINANCE LEASING FOR CAPITAL FORMATION

Kabazzi Maurice Lwanga\*

## ABSTRACT

*Leasing is an important tool of economic development. Yet Uganda's legislative or regulatory framework is still behind times. Since the advent of the Mortgage Act no. 9 of 2008 and the Securities in Movable Property Act 2019, the economic law related to leases has received little attention. This article argues for adoption of legislative or regulatory framework to guide the judges in decision making and increase Uganda's competitiveness for investment to promote economic growth. Importantly, it highlights the considerations for a lease agreement as apart from hire purchase and loan facility, further illustrates the inconsistent jurisprudence on the obligation to pay future installments after the termination of the lease agreement. It concludes that Uganda lacks a competitive edge in the modern economic field due to lack of regulatory enforcement on capital-incentive-law via leasing.*

## 1.0 INTRODUCTION

Uganda as an emerging economy is an attractive investment destination with new opportunities in Oil & Gas as well as Mining.<sup>1</sup> However, financial laws regulating investment funding<sup>2</sup> still need to be realigned toward capital formation<sup>3</sup>. The current economic law regulates only traditional debt financing methods such as loans backed by collateral securities in land<sup>4</sup>, debentures<sup>5</sup> and chattels mortgages<sup>6</sup>.

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\* A clinical student of Commercial law with a keen interest in Finance and Economics. I am grateful to SC Kabiito Karamagi (Esq) of Ligomarc Advocates for the guidance in finance leasing. All mistakes are solely mine.

<sup>1</sup> Lease agreements can be entered with all industrial customers. See generally Awori Baisama on Lovea Axis through Toyota Uganda Limited at 34 accessed at

<https://www.ucmp.ug/storage/app/public/uploads/mRjz4DgqKA4KIG4UfH6gl71A1QDvKrNKSR2P7fOe.pdf> [accessed 5 September 2021]

<sup>2</sup> Access to finance is key among these challenges as lack of finance holds back the growth of SMEs, limiting employment opportunities, tax payments and economic growth.

<sup>3</sup> The leasing model of Public Private Partnerships supports investment and project finance.

<sup>4</sup> Mortgage Act no. 8 of 2009 *cap* 229 and Tier 4 Microfinance Institutions and Money Lenders Act 2016

<sup>5</sup> Companies Act No. 1 of 2012

<sup>6</sup> Security in Moveable Property Act No. 8 of 2019

Failing to adopt a finance leasing law disadvantages Uganda's financial sector<sup>7</sup>. In other jurisdictions, failures in financial laws and contracting contributed to the banking collapse of 2008 in the United States and the subsequent recession, which was less severe in Japan and Germany<sup>8</sup>. Also, the absence of secure property and reliable contracts paralyze the economies of some poor nations<sup>9</sup>. Improving effectiveness of law in low-income countries is important to their economic development.<sup>10</sup>

The function of leasing in capital formation in many emerging market economies has received minimal attention in academic literature. Instead, literature has focused on investment funding for financing ownership of capital assets, either through microfinance or formalization of possessory rights<sup>11</sup>.

Finance leasing is a form of investment funding<sup>12</sup>. Marwan Mohammad Abu Orabi argues that it is the cornerstone of infrastructure projects in general and industrial companies because of the high capital costs as well as the continued need for working capital. In International Trade, the UNIDROIT Convention on International Leasing is intended not only to facilitate the international leasing operations, but also to serve as a model for future national legislation. A finance lease law can enable Uganda increase her participation in International Trade<sup>13</sup>.

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<sup>7</sup> Access to capital is widely understood to be one of the biggest constraints to business growth in Uganda. See [https://www.ifad.org/documents/38714170/43264647/policy+brief\\_Uganda\\_web.pdf/27c99674-56cd-daa0-fe52-2da4bc982a6e?t=1624002784643](https://www.ifad.org/documents/38714170/43264647/policy+brief_Uganda_web.pdf/27c99674-56cd-daa0-fe52-2da4bc982a6e?t=1624002784643) [accessed 7 September 2021]

<sup>8</sup> Merrill: The Economics of Leasing Downloaded from <https://academic.oup.com/jla/article/doi/10.1093/jla/laaa003/5904227> [accessed 9 July 2021]

<sup>9</sup> An Introduction to Law and Economics

<sup>10</sup> See generally INTERNATIONAL FINANCE CORPORATION, LEASING IN EMERGING MARKETS (The World Bank 1996). Report highlights that "leasing has expanded rapidly over the past 20 years in developing countries," to the point that "in 1994 over US\$350 billion of new vehicles, machinery and equipment was financed through leasing." cited by Merrill: The Economics of Leasing

<sup>11</sup> E.g., Hernando de Soto, *The Mystery of Capital* (2000). See generally Merrill: The Economics of Leasing

<sup>12</sup> See <https://www.mopnitor.co.ug/uganda/business/propser/leasing-as-a-means-of-asset-financing-1897356?view=htmlamp> [accessed 7 September 2021]

<sup>13</sup> In Nigeria, Power Purchase Agreements and Leasing (to-own) structures have

This article is an exposition of the legal challenges on lack of regulatory enforcement<sup>14</sup> in lease financing. It concludes that lack of regulation could negatively affect Uganda's competitiveness accessing the scarce investment capital for economic development<sup>15</sup>.

To reflect upon the regulatory risk<sup>16</sup> of finance leasing in the Republic of Uganda, an outstanding example is BOUs' Credit Relief Guidelines for the banking industry in response to the COVID-19 pandemic. The Guidelines on loan restructuring envisaged only traditional bank loan facilities in form of mortgages, chattel mortgages and debentures. Therefore, it could be argued that loan restructuring was aimed at bank loans only without considering finance leases. However, it can also be argued that loan restructuring impliedly includes credit agreements such as finance leases.

Leases and loans are simply two different methods of asset financing. One finances the use of equipment, the other finances the purchase of equipment. Although finance lease contracts are not bank loans and would not be categorized for the loan restructuring<sup>17</sup> exercise by Financial

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emerged as viable business models. Nigeria's Equipment Leasing Act of 2015 regulates leasing activities in the energy sector.

<sup>14</sup> This phenomenon has been referred to as "contrat sans loi" in the sense that such law as has grown up in respect of these techniques has fallen within the range of expression of the parties 'freedom of contract. UNIDROIT, Preliminary draft uniform rules on international financial leasing, explanatory report, Rome, 1985. See generally; Uarda Roshi, PhD Candidate, 'A LEGAL ANALYSIS OF FINANCIAL LEASING AND ITS UNIFICATION BY UNIDROIT', European International Virtual Congress of Researchers 2016-1 ISSN 2059-2752

<sup>15</sup> In most developing countries, mining capital is foreign in origin, and as is known in general, such capital is scarce, and timid with regard to venturing into countries it perceives as risky. This means that developing countries are constantly engaged in a worldwide fierce competition for the scarce capital to develop their minerals. Those nations with prospective geology, reasonable tax, acceptable legislation and political stability have a brighter prospect than those where one or more of these elements are absent. See generally Denis Kusaasira 'Is Production Sharing in Mining Projects Tenable?'

<sup>16</sup> By "regulatory risk" we mean (1) the risks flowing from vague and conflicting laws, whose interpretations may depend on the whims of courts and officials subject to political or economic pressures or corruption, and (2) the risks of unexpected changes in the law that will adversely affect the investee business or the investor, including changes in taxation laws, reversal of previously granted incentives or subsidies, and revocation of licenses or permits. See also 559 Nathan Abbot Way Stanford, CA 'Impact Investing In the Absence of Credible Legal Institutions <https://law.stanford.edu/education/only-at-sls/law-policy-lab/> [accessed 21 July 2021]

<sup>17</sup> Restructuring would involve wide ranging modification of loan terms to recognize the

Institutions, worthy of note is that the lender-creditor relationship under loans with banking institutions cannot be imputed to the lessor and lessee relationship under lease finance. That is not our concern here.

Uganda is largely dependent on agriculture<sup>18</sup> and equipment leasing could be the best investment funding if the legal framework is established. Most small manufacturing companies face the problem of lack of finances or access to credit facilities. This reduces their ability to acquire capital equipment. Leasing plays a significant role in economic growth.

Businesses and individuals have moved away from owning tools of trade such as cars, aircrafts and factory equipment. The foundation for successful outcomes is the optimal financial approach, whether in the private or public sector. Within our East African region, the Kenya Government for instance leases its vehicles<sup>19</sup>. The adoption of the leasing model when properly implemented by African Governments has the potential to greatly enhance service delivery in public health, security, infrastructure development, education, and other areas of society.

This article does not purport to lay down the black-letter model for legislators to design a legal framework on lease financing<sup>20</sup>. It points out contentious areas in case law for reform touching upon contracts of finance leases. It argues that finance leasing law should be established because such law can normatively create legitimacy and legal certainty and tax reform on leased assets in Uganda's investment environment.

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value loss relative to the original terms in the credit contracts, and to share this value loss between the lender and the equity holders. These options could include; reduction of the loan principal, extension on payment deadline, add or change the creditor or guarantor, lower interest rates and provide a non-repayment grace period for a specific period of time.

<sup>18</sup> From an economic perspective financial leasing can be defined as a financing technique for medium to long-term investments in which the lessor puts directly at the disposal of the lessee the equipment instead of the money needed for their purchase.

<sup>19</sup> Awori Baisama (*supra*) Innovative Fleet Solutions-The Uganda Chamber of Mines & Petroleum at pg 34

<sup>20</sup> In 2011, the Uganda Law Reform Commission with the Private Sector Competitive Project of the International Finance Corporation through the Private Sector Foundation published a study report on Finance Leasing but a Finance Leasing Bill remains to be published and debated as of 2021

Section 2.1 sets out the componential aspects of a finance lease and nature of lease transaction and distinguish it from other transactions such hire purchase, sale of goods, loan and lease in land. Section 3 discusses the legal challenges of finance leases in jurisprudence and lack of regulation. Further, it highlights the normative importance of a regulatory and legislative framework for lease financing in Uganda. This section sheds light on the nexus between regulatory enforcement in legal environment and the economic prospect of Uganda's competitiveness for investment and efficiency in capital formation. Of particular interest to the health crisis in Uganda, it concludes that leasing can enable government support the infrastructural health system to reduce health-related costs through leasing in the post-pandemic Uganda.

## **2.1 WHAT FINANCE LEASING IS ABOUT**

Leases are generally multidisciplinary industries related to taxation, finance, accounting and law<sup>21</sup>. A Finance lease is a fixed term lease used by a business to finance the Capital Equipment<sup>22</sup>. Today, leases are used to acquire the rights to a very wide variety of assets.

Resources that are commonly leased include agricultural land, mineral and timber rights, office buildings, shopping centres, industrial and commercial equipment such as ships, aircraft, farm machinery and computers, residences including both freestanding houses and apartments, autos and other motor vehicles, and furniture, among other things. Other than ownership, the lease is probably the most common legal form of holding assets throughout the world<sup>23</sup>.

Whereas there is no particular statutory framework that defines finance leasing in Uganda, Section 3 of the Financial Institutions Act 2004

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<sup>21</sup> Lina Maulidiana, Implementation of Leasing Contract in Non-Banking Finance Institutions. *European Research Studies Journal* Volume XXI, Issue 4, 2018 pp. 255-267

See generally Black's Law Dictionary

<sup>23</sup> Thomas W. Merrill, The Economics of Leasing, *JOURNAL OF LEGAL ANALYSIS*, VOL. 12, P. 221, 2020; COLUMBIA UNIVERSITY SCHOOL OF LAW, THE CENTER FOR LAW & ECONOMIC STUDIES WORKING PAPER NO. 628 (2020). Available at: [https://scholarship.law.columbia.edu/faculty\\_scholarship/2709](https://scholarship.law.columbia.edu/faculty_scholarship/2709) [Accessed 7 September 2021]

recognises it. Section 4 of the VAT Act provides for taxation of rent earned from finance leases. Section 59 of the Income Tax Act imposes tax on income derived from finance leases. Consequently, the leasing transactions are guided by principles of common law under section 14 (2) of the Judicature Act.

Furthermore, finance leasing is provided for under Section 34(7) of the Public Finance Management Act<sup>24</sup> to the effect that where a vote requires to acquire an asset by lease, the Accounting Officer shall obtain the authorization of the Secretary to the Treasury prior.

In a finance lease, the lessee selects the equipment to be supplied by a manufacturer or dealer but the lessor (a finance company) provides funds, acquires title to the equipment and allows the lessee to use it for all (or most) of its expected useful life. During the lease period, the usual risks and rewards of ownership are transferred to the lessee, who bears the risk of loss, destructions and depreciation of the leased equipment (fair wear and tear only expected) and of its obsolescence or malfunctions. The lessee also bears the costs of maintenance, repairs and insurance<sup>25</sup>.

The regular rental payments during the rental period are calculated to enable the lessor amortise its capital outlay and to make a profit from its finance charges. At the end of the primary leasing period, there will frequently be a secondary leasing period during which the lessee may opt to continue to lease at a nominal rental or the equipment may be sold and a proportion of the sale proceeds returned to the lessee as a rebate of rentals.

The lessee thus acquires any residual value in the equipment, after the lessor has recouped its investment and charges. If the lease is terminated prematurely, the lessor is entitled to recoup its capital investment (less the realizable value of the equipment at the time) and its expected finance charges (less an allowance to reflect the accelerated return of capital). The

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<sup>24</sup> Act 3 Public Finance Management Act 2015

<sup>25</sup> Samuel Black T/A S B Coaches v DFCU BANK Ltd (Civil Suit-2009/416) [2015] UGHCCD 69 (20 August 2015) <https://www.ulii.org/ug/judgment/hc-civil-division-uganda/2015/69> [Accessed 7 September 2021]

bailment which underlines finance leasing is therefore only a device to provide the finance company with a security interest (reversionary right)<sup>26</sup>”.

The lease contract includes the following features:

- (i) characteristics of the asset that determines its type and state.
- (ii) Contract Duration (iii) the leasing value of the asset (periodic payments paid by the lessee to the lessor (iv) nature of these payments: are they equal or decreasing or increasing instalments. (v) the fair value of the asset (market value) of the asset (vi) Residual Value (fair market value of the leased asset at the end of the contract period) (vii) Responsibility for the expenses of the asset during the period of the leasing contract: the expenses related to the implementation of the contract, such as the asset maintenance expenses, taxes and insurance on the leased asset.
- (viii) The option to purchase the leased asset at a discounted price
- (ix) Renewal option (if available)

**Table 1**  
**Categories of commercial equipment (operating) leases**

Category	Description
Operating lease	A lease which covers an asset for a shorter period of time than its useful life. The lessor thus assumes a greater risk but retains a greater residual value in the asset, and may also provide services such as maintenance and insurance for the leased asset. A significant portion of the lessor’s profit comes from disposal of the asset at the end of the lease term.
Capital (finance) lease	A lease in which the lessor retains title to an asset, but the lessee retains control over the asset for substantially all of its useful life. The lease payments cover most or all of the lessor’s capital outlay. The lessee is responsible for maintenance, insurance, and taxes on the leased asset.
Leveraged lease	A lease in which the lessor finances a substantial part of the cost of the leased asset through one or more investors. In case of nonpayment by the lessor, the investor has legal recourse against the leased asset rather than the lessor.
Synthetic lease	A lease which allows the lessee the benefits of ownership of a leased asset for tax purposes, while maintaining “off-balance-sheet” financing for accounting purposes.

Source: Chris Boobyer, *Leasing Finance*, 3<sup>rd</sup> ed. (East Rutherford, NJ: Euromoney-World Publications, 1997); and Tim Lintott, “Synthetic Leasing,” in *World Leasing Yearbook 2002* (Colchester, Essex, United Kingdom: Euromoney Institutional Investor PLC, 2002), pp. 22-25.

**Sourced from:** The U.S. International Trade Commission (ITC) 3562 of October 2002

<sup>26</sup> Chitty on Contracts, 27th Edition Vol.7



Finance leasing is related to leasing of income-earning equipment<sup>27</sup>. Non-finance leases are usually operating leases and operating leases cover non-income-generating equipment such as: telephone equipment, computer hardware, office equipment such as furniture.

## **2.2 Advantages of Leasing**

*Perfection of security.* The advantage of leasing is that the acquisition of a leased asset is easier than foreclosure of collateral from a secured loan, which implies that the lease has a higher debt capacity than a secured loan<sup>28</sup>.

*Absent interest rates.* The fact that the interest charge is transparent in the case of the loan and is missing in the case of a lease is not just a product of convention or regulatory lassitude<sup>29</sup>. It reflects the fact that the expected return from leasing is based on the opportunity costs of using a tangible asset, which is highly idiosyncratic to the nature of the asset, as opposed to the opportunity costs of holding cash, which is not<sup>30</sup>. It also achieves a lot of advantages through the modernization of equipment and selection of advanced technology necessary to raise production efficiency and increase competitiveness<sup>31</sup>

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<sup>27</sup> John F Varcoe, 'Finance Leasing-An Analysis of the Lessor's Rights upon Defaults by the Lessee' (1976) 1 Can Bus LJ 117

<sup>28</sup> (Eisfeldt et al., 2009; Permana, 2017) cited by Lina Maulidiana(2018) Implementation of Leasing Contract in Non-Banking Finance Institutions, European Research Studies Journal Volume XXI, Issue 4, 2018 pp. 255-267  
[https://www.ersj.eu/dmdocuments/2018\\_XXI\\_4\\_20.pdf](https://www.ersj.eu/dmdocuments/2018_XXI_4_20.pdf) [accessed 5 September 2021]

<sup>29</sup> Even in today's world of consumer protection laws and mandatory disclosure, U.S. law does not require disclosure of the implicit rate of interest in consumer leases. The regulations promulgated under the Consumer Leasing Act (CLA), enacted in 1976, do not require the disclosure of an implicit interest charge. See 12 CFR § 213.4 (2017) (requiring, for motor vehicle leases, that "lessors must provide a mathematical progression showing how the scheduled periodic payment is derived.... In addition, lessors must disclose information about certain lease contract terms such as the penalty for terminating the lease early, maintenance responsibilities, and whether the lessee has the option to purchase the leased property.")  
<https://www.federalreserve.gov/bankinforeg/regmccg.htm> [accessed 9 July 2021]

<sup>30</sup> Several commentators have observed that lessors are resistant to disclosing any "implicit rate of interest" is included in their leases. The resistance may be due not to the fact that this is a proprietary secret so much as that any particular number would be artificial

<sup>31</sup> Marwan Mohammad Abu Orabi, The Impact of Leasing Decisions on the Financial

*Get Less/ Pay less.* The major advantage of leases as a financing device is that they allow assets to be acquired at lower cost<sup>32</sup>. The irrelevance theorem takes as its implicit model a well-capitalized business firm deciding whether to acquire equipment by lease or purchase<sup>33</sup>.

*Modernization of production.* Leasing offers a way to modernize production and develop small businesses; allows technological refresh and sometimes provides off balance sheet financing (for countries where finance lease is classified as a “lease” and not a loan)<sup>34</sup>. The leasing process has a significant contribution to all businesses as it enabled them to use advanced technology which cannot be bought and constantly updated. Leasing has helped to create more profitable outlets and new activities to banks where profits have become increasingly grown<sup>35</sup>.

*Simple to structure lease deals/low transaction costs*<sup>36</sup>. A lease can be concluded more quickly and simply than a bank loan. The lessor is only interested in determining the ability of the leased goods to generate sufficient cash flow to pay monthly rentals throughout the lease term.

*Tax Incentives:* In many countries the tax system is normally conducive to leasing. Tax incentives differ from country to country. According to the US International Trade Commission, the cross-border commercial equipment leasing industry is founded in part on the ability of both lessors and lessees to benefit from differences in international tax regimes, which often make it more advantageous for firms that acquire commercial equipment to lease new assets rather than to purchase them.

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32 Performance of Industrial Companies. *Global Journal of Management and Business Research: C Finance*-The World Islamic Science University, Jordan, 2014  
<https://academic.oup.com/jla/article/doi/10.1093/jla/laaa003/5904227>  
[accessed 9 July 2021]

33 Merrill: The Economics of Leasing Downloaded from  
<https://academic.oup.com/jla/article/doi/10.1093/jla/laaa003/5904227>  
[accessed 9 July 2021]  
Tanzania Leasing handbook  
<https://documents1.worldbank.org/curated/en/965241468173378720/pdf/402560TZ0Leasing0snapshot01PUBLIC1.pdf> [accessed 9 July 2021]

35 Mohammed Yasin Al Subuu (2003)

36 Tanzania Leasing handbook *supra*

*Enhanced Security for Lessors*<sup>37</sup>. A secondary advantage of leases as a financing device is that they provide greater protection for lessors in event of default than is provided to lenders holding security interests in a purchased asset. In both cases, the primary concern is non-payment. Lessors have better protection against non-payment than do lenders holding security interests.

### **2.3 Pillars of a valid finance lease:**

Because of the importance of contract promises as compared with other promises, namely, legal enforceability, the law of contract must determine when or if a contract has been made<sup>38</sup>. Above all, if the finance lease agreement is inconsistent with principles of contract law such as offer, acceptance, consideration and intention to create legal relations<sup>39</sup>, such lease contract is liable to be invalid. Furthermore, such lease contract must be in writing and signed.

#### **I. As three-party transaction**

Contracts financed by Leasing Financing Company involve three parties, the legal status of the parties is as follows: between the lessor (buyer) and the supplier (seller), between the lessee (tenant) and the lessor (the party who rents the capital goods) and between the lessor (owner of capital goods) and leasing company. The finance company may also act as a lessor, if it does not involve other parties in the financing<sup>40</sup>.

There are different opinions whether finance leasing is a three party or a two-party arrangement. The International Finance Corporation (IFC) differentiates a finance lease agreement, which it believes to be a two-party agreement between a lessor and lessee, from a financial lease transaction;

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<sup>37</sup> This is perhaps the most important advantage in developing countries, where unclear property rights, poorly functioning asset registries, and weak laws of secured transaction constrain lending.

<sup>38</sup> Formal Requirements of Contract Formation by Henry Nampandu 'Contract Law Aspects of Electronic Commercial Transactions' Uganda Living Law Journal Vol. 1 No. 1 of 2003 at pg. 69

<sup>39</sup> The elements for a valid contract are not exhausted in this list

<sup>40</sup> Lina Maulidiana, 'Implementation of Leasing Contract in Non-Banking Finance Institutions', European Research Studies Journal Volume XXI, Issue 4, 2018 pp. 255-267

which it believes to be a three-party transaction involving an enterprise (as lessee), an equipment supplier (as lessor), and a bank, finance or leasing company (as intermediary financier).

IFC is interested in promoting leasing as a financial product and believes that operating leases could be best left to contract. IFC also believes, however, that operating leases can be legislated for if countries require legislative guidance for these types of leases<sup>41</sup>

## II. The legal effect of a valid finance lease

The ownership of the leased vehicle remains with the lessor by acquisition of its title, the usual risks and rewards of ownership are transferred to the lessee, who bears the risk of loss, destructions and depreciation of the leased equipment. It is also clear that the ownership of the leased vehicle by the lessor is meant to secure the lessor's interest to ensure that the lessor recovers its capital investment and profit thereto<sup>42</sup>.

### **2.4 The nature of finance lease agreement**

*The lessor must not be the seller of the goods.* This is evident in the definition below; however, due to lack of regulation in Uganda, the seller can also be the lessor. The main characteristics of the process of leasing as has been identified by the Union of equipment leasing within the definition of Leasing context as "a contract between the lessor and the lessee in order to lease a specific asset from a distributor or an industrial company specialized in such assets at which the lessor retains the asset<sup>43</sup>.

A finance lease is "a lease in which (1) the lessor does not select, manufacture, or supply the goods, (2) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease, and (3) either (i) the lessee receives a copy of the contract evidencing the lessor's purchase of the goods or a disclaimer statement on or before signing the

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<sup>41</sup> Tanzania Leasing Handbook.

<sup>42</sup> Nassolo Farida vs DFCU Leasing Company Ltd HCCS No.536/2006, Hon. Justice Lameck Mukasa

<sup>43</sup> The Impact of Leasing Decisions on the Financial Performance of Industrial Companies 2 Year ( ) C © 2014 Global Journals Inc. (US) 32Global Journal of Management and Business Research Volume XIV Issue II Version I Year ( ) C © 2014 Global Journals Inc. (US) 2014

lease contract, or (ii) the lessee's approval of the contract evidencing the lessor's purchase of the goods or a disclaimer statement is a condition to effectiveness of the lease contract." disclaimer statement is a condition to effectiveness of the lease contract."

Lease is a mixed agreement, contained elements of sale and purchase agreement, lease and lease rental. In practice it is not easy to determine which laws apply in mixed agreements such as Leases. According to the theory of absorption in the mixed agreement applied the most dominant agreement<sup>44</sup> which is equivalent to the notion that a lease is a form of transaction having double legal aspects, which will someday be termed as lease and at certain times will be considered as a form of purchase mortgage<sup>45</sup>.

*The lease agreement is non-cancellable.* Such leases often contain what is commonly referred to as a "hell or high water" clause<sup>46</sup>, which makes payment obligations irrevocable and unconditional once leased goods are accepted. Such clauses require lease payments to be made "no matter what." Courts generally enforce such clauses in nonconsumer financial leases<sup>47</sup>.

*The intention is not to transfer asset ownership.* From the perspective of banks, Lease financing is not intended or designed that the lessor will own the assets for itself. It is the process of leasing the asset to be made available for the customer to use the finance against the performance of the value of the lease to be agreed upon, and by the end of the lease period this asset may be sold in public auction, or sold to the lessee or returned to the lessor to re-lease it again. However, a lease may have an option to sale. In this case, the lessee may buy the leased equipment at the end of the lease period.

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<sup>44</sup> Lina Maulidiana supra citing (Suharmoko, 2004)

<sup>45</sup> (Muhammad, 2013) cited by Lina Maulidiana(2018)

<sup>46</sup> See generally Peter Breslauer, Finance Lease Hell or High Water Clause and Third Party Beneficiary Theory in Article 2A of the Uniform Commercial Code, 77 Cornell L. Rev. 318 (1992) Available at: <http://scholarship.law.cornell.edu/clr/vol77/iss2/4> [accessed 7 September 2021]

<sup>47</sup> See *Leasetec Corp. v. Orient Sys., Inc.*, 85 F. Supp. 2d 1310, 1316 (S.D. Fla. 1999).

*The Security.* The form of collateral in the Lease Fund Contract may be in the form of a principal guarantee, and additional security. Some legal scholars argue that the leased equipment/capital good is the security for the credit-based transaction. Thus, there is no need to furnish additional security for the lease agreement. This is a matter in discretion of the lessor who may require additional security by the prospective lessee before entering into a lease contract.

In some cases, a lessee may be required to pay a security deposit. The Security Deposit paid by a lessee has encountered criticism because of its resemblance to a "down payment" in a time-sales transaction<sup>48</sup>. Yet it is a very customary provision in real estate leases as well.

### **2.5 Distinction from agency, sale of goods and hire purchase**

A major distinction is the existence of two legal relationships: the first is the relationship between the supplier and the lessee, this is a selling one<sup>49</sup>. The second relationship is between the lessee and the lessor, and it is a leasing relationship, and the researcher concluded that these two relationships are integrated to form a leasing contract.

The most important results of this study were: The leasing contracts are the most important financial contracts, which play an important role and essential to the national economy, especially in developing countries. The leasing contract is made up of three parties which are: the lessor who is buying the assets, and the supplier who sells the assets, and the lessee who rents these assets. The leasing contract is distinguished from other financial contracts as it is composed of three contracts: the sale, the agency and the lease.

### **3.0 LEGAL CHALLENGES OF FINANCE LEASING**

Finance leases have been challenged as illegal for lack of law, inter alia, that they are ingenuous circumvention of the law. But the court has settled the position that such an agreement between the parties is not an agreement for

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<sup>48</sup> Fairfax Leary Jr, 'The Procrustean Bed of Finance Leasing' (1981) 56 NYU L Rev 1061 at pg. 1093

<sup>49</sup> Bashar Jamal Nimr (2000)

the sale of goods and the provisions of the Sale of Goods and Supply of Services Act<sup>50</sup> are inapplicable to the transaction. Also, that the Chattels Transfer Act<sup>51</sup> is likewise inapplicable. Suffice to say, the master lease agreement is not an ingenious circumvention of the law and there is nothing to suggest that it is an illegal contract under the laws of Uganda. Because there is no statutory framework, the contract is governed by the common law<sup>52</sup>. The Finance leasing law will facilitate legality and protection of businesses in leasing.

### **3.1 Case Law and Its Legal Implications to Economics of Leasing**

Economics conceives of laws as incentives for changing behavior (implicit prices) and as instruments for policy objectives (efficiency and distribution)<sup>53</sup>. Under this section, I will argue on the normativity of Ugandan decisions affecting finance leasing:

*Late rental payments amount to repudiation of the lease agreement.* If a lessee delays to make a lease payment, such conduct with or without notice amounts to repudiation of the contract, then the lessor can foreclose the leased asset. In the decision of the High Court decision in the case of *Kalule Deo V Stanbic [U] Ltd*<sup>54</sup>, the court considered the issue whether a default on installment can be a default on the whole lease.

The defendant was the lessor of motor vehicle tata lorry reg. No. UAM 504N, the plaintiff defaulted in making payments within the time required. The plaintiff pleaded that the defendant's agent had misrepresented the bank by falsely telling the plaintiff that he was meant to pay the 1<sup>st</sup> instalment in November, 2009 yet the plaintiff was meant to pay it in October 2009 according to the lease agreement. Subsequently, the defendant's agents attached the tata lorry without notice to the plaintiff.

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<sup>50</sup> This law was repealed and replaced by the Sale of Goods and Supply of Services Act 2017

<sup>51</sup> This law was repealed by the Securities in Moveable Property Act No. 8 of 2019

<sup>52</sup> S.14 of Judicature Act see the *dictum of Justice Madrama in Glays Nyangire v DFCU Leasing Co. Ltd*

<sup>53</sup> An Introduction to Law and Economics

<sup>54</sup> HCCS no. 518 of 2014

B. Kainamura J found *inter alia* that one default is sufficient no matter whether the instalments are regularized later, it can amount to a breach of the whole lease contract.<sup>55</sup> This agrees with the principle in *Lombard North Central plc versus Butterworth* that failure to pay promptly instalment payments or rentals under the specific contractual terms went to the root of the contract and was a fundamental breach. This means that late payment is not justifiable at all and that the lessee even with reasonable excuse cannot object to the foreclosure as such delay amounts to repudiation of the lease agreement.

*Notice before termination can be done away with in the lease agreement.* It is noteworthy that under section 7 (1) of the *Mortgage Act* a mortgagee is required to give at least 60 days' notice of intention to realise security under the mortgage. In a finance lease, such notice is not mandatory. In fact, due to freedom of contract, parties can contract out of the right to notice before termination or repossession without notice. Suffice to say, the doctrine of notice could be incorporated into the finance leasing law.

In *Otaok Charles versus Equity Bank*<sup>56</sup>, under the finance lease agreement the defendant advanced to the plaintiff 23,000,000 shillings to purchase a motor vehicle. Upon default on the rental payments, the motor vehicle was repossessed by the defendant on 5 October 2009 and sold on 6<sup>th</sup> October 2009 at Ugandan shillings 9,000,000/=.

The vehicle was sold by private treaty under an arrangement where no notice was given to the plaintiff or the notice that was issued was violated. In this case, the lease agreement provided that the sale of the leased asset may take place with or without notice. The defendant gave the plaintiff a notice of 7 days and seized the vehicle on the same day.

The court interpreted the lease contract to mean that notice was not mandatory; however, the procedure of notice was endorsed by court

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<sup>55</sup> It does not matter that the lessee later regularizes payments or explains the reason for delay.

<sup>56</sup> HCCS 335 of 2010 of the Republic of Uganda



adopting the doctrine of estoppels to prevent the defendant from violating its duty of good faith under the process of notice.

*The controversy on the future rental payments after repossession<sup>57</sup> of the lease remains.* Yet, there is no limit on the amount recoverable by the lessee. For instance, the leasing law in Namibia<sup>58</sup> limits the lessor from recovery of an amount exceeding the sum of the principal debt owing to him by the lessee. According to Ugandan courts, all the future rental payments become due upon termination of the lease. The financier has to recover its money together with profit upon financing the purchase of the equipment<sup>59</sup>.

*In the decision Otaok Charles versus Equity Bank<sup>60</sup>.* Under the finance lease agreement the defendant advanced to the plaintiff 23,000,000 shillings to purchase a motor vehicle. The plaintiff defaulted in payments and the motor vehicle was repossessed and sold. The plaintiff challenged the repossession and the recovery of future rental installments after termination as unlawful.

Justice Madrama at High Court (as he then was) *held that the defendant has no right to future rentals after they have terminated the agreements and got the vehicle back.* Justice Madrama as he then was considered the rule of law to be that termination of an agreement brings to an end the obligations of the parties up to the date of the termination subject to recovery of damages or injuries that have occurred up to that point.

In this reasoning, the learned judge relied on *Lombard North-Central Plc versus Butterworth<sup>61</sup>* and judgment of Lord Mustill at page 271 where his Lordship held that where a breach goes to the root of the contract, the injured party may elect to put an end to the contract and thereupon both sides are relieved from those obligations which remain unperformed. The court did not make a finding as to whether there was repudiatory breach by the lessee entitling the lessor to claim the whole amount due in future rentals.

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<sup>57</sup> This is consequent to foreclosing the leased asset

<sup>58</sup> Usury Amendment Act 1987 Namibia

<sup>59</sup> The rationale for payment of future rentals, include considerations that the equipment is brought at the request and requirement of the borrower/lessee.

<sup>60</sup> HCCS 335 of 2010

<sup>61</sup> [1987] 1 All ER 667

This decision caused uncertainty on whether the lessor is entitled to future rentals/lease payments after termination of the lease. But the court in the decision of *Gladys Nyangire Karumu versus Dfcu Leasing Company Limited & 3 Ors*<sup>62</sup>, departed from its precedent and stated that the lessor is entitled to future installments after the date of termination.

Similarly, the decision in *Deluxe Enterprises Ltd versus Uganda Leasing Company*, honourable Lady Justice Constance Byamugisha as she then was held on the question of future payments that the court would enforce the contractual terms of the master lease agreement which entitled the leasing company to demand future rentals. In this case, the plaintiff contended that the demand for future payments amounted to a penalty.

The court found that the request to terminate the lease amounted to a repudiation which called for payments of future instalments after the date of termination. In another case of *Nassolo Farida versus DFCU Leasing Company Ltd*; honourable Justice Lamech Mukasa ordered payment of future rentals where the lessee had requested to terminate the lease.

This decision aligns with the long standing principle in *Anglo-Auto Finance Co., Ltd. v. James*<sup>63</sup> the Court of Appeal considered a minimum payment clause which required payment of all monies in arrears to the date of repossession plus a sum equal to the amount (if any) by which the hire-purchase price (less deposit and rents already paid) exceeded the net amount realized on the sale of the car. The finance company repossessed and sold the car when the rent was one payment in arrears and sued the hirer for the deficiency. The court held the amount recoverable was the rent in arrears to the date of termination plus costs of repossession, the balance being a penalty.

The justification for future rentals is that the bank as the financial institution does not deal in the equipment. Its business is to finance the purchase of the equipment and it is the lessee who is expected to know about the equipment he or she needs for his/her business. Upon ascertaining the creditworthiness of the applicant to repay the credit facility,

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<sup>62</sup> HIGH COURT CIVIL SUITS NOS 106, 150 AND 788 OF 2007

<sup>63</sup> [1963] 3 All E.R. 566 (C.A.).

the bank's role is to finance the purchase of equipment. The holding of the legal title to the property is for purposes of security and entitlement of repossession of the equipment in the event of the lessee's default.

Although the judges are grappling with the lessor's right to future rental payments after termination and after repossession, the Finance lawyers have no easy task ahead.

*There is a division of rights in the asset but no division of title or ownership of the asset.* Another controversial area has been whether contribution by the lessee toward the purchase created an interest in the leased asset. As noted earlier that a security deposit paid does not create any equitable interest or title for the lessee.

In Otaok's case, the plaintiff contributed 2 million toward the purchase of the leased vehicle as the defendant company contributed 23 million shillings. But this contribution as in any finance leasing activity does not create any legal or equitable interest in the lessee.

The courts are grappling with interpretation and workings of lease activities. In some cases, a lease is construed as if a hire purchase contract. For instance, the practice of requiring a prospective lessee to contribute a percentage, say 10% of the purchase price, tends to impress the judges that such lessee becomes a joint owner of the asset with the lessor. Yet the lessee's contribution to the purchase price helps to reduce the lease payments which overall creates efficiency in the leasing activity<sup>64</sup>.

*Hell or high waters cause injustice during the COVID-19; take the example of Otaok Charles versus Equity Bank*<sup>65</sup>. The court stated that the material hell or high water clause was to the effect that even where the asset has sustained damage that takes it out of service, the lessee has to continue to pay their rentals for such period the asset may be out of service<sup>66</sup>.

There is scarcely any jurisprudence highlighting exceptions to the prompt lease payments. In the decision of *Samuel Black T/A Sb Coaches versus Dfcu*

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<sup>64</sup> No down payment is required. Leasing is, by definition, 100 per cent financing. However, the lessor sometimes requires a "deposit" or prepaid rental payments.

<sup>65</sup> HCCS 335 of 2010

<sup>66</sup> Peter Breslauer, *supra*

*Ltd*<sup>67</sup>, the plaintiff and Uganda Leasing Company Ltd (the defendant's assignor) executed a Master Vehicle Lease Agreement on 3<sup>rd</sup>/04/1998 wherein the defendant agreed to lease buses to the plaintiff for his transportation business. The buses were destroyed by a fire started by strangers in an act of war.

The plaintiff sought a moratorium on payments of the lease. The defendant contended that the plaintiff breached his obligation to pay the termination sum for the destroyed buses. The defendant further averred that it was the duty of the plaintiff to pay insurance for the leased buses and all the risk to the buses during the lease term lay on the plaintiff.

The court held that the plaintiff was liable to pay the lease payments given that the duty of insurance lied on him. This case was decided on other considerations of duty to insure the lease asset<sup>68</sup>; however, it is evident that a lessee must comply with the lease payments irrespective of damage or destruction of the equipment.

As noted earlier, the Credit Relief Measures by Bank for Uganda to financial institutions in COVID-19 do not provide for finance leases; therefore, the periodic rentals must be paid by the lessee notwithstanding the pandemic<sup>69</sup>.

*The unfair terms which require mortgage as a prerequisite to create a lease agreement.* The mortgaging of land as a prerequisite or additional security to finance leasing should be unlawful because such exercise turns leasing business into a lending business. Given that a finance lease is different from a chattels mortgage or loan facility backed by security in land, I argue that the lessor's reversionary right could constitute its security interest in the leased equipment.

The law is silent on whether additional security is required for a lease. Indeed, demand may have it that the bank or leasing company requires the

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<sup>67</sup> CIVIL SUIT NO. 416 OF 2009

<sup>68</sup> A moveable asset which can legally sold in or implied into the Republic that becomes the subject matter of a finance lease agreement, whether or not the asset has become a fixture to or incorporated in land. Se generally, s.21 of the Finance Lease Act of Ghana

<sup>69</sup> See <https://www.health.go.ug/covid/about-corona-virus/> [accessed 20 February 2021]

lessee to enter into a mortgage as security for lease agreement. Moreover the lease may be converted into a mortgage. In *Samuel Black T/A Sb Coaches V Dfcu Ltd*<sup>70</sup>, the lease financing was secured by a legal mortgage dated 15<sup>th</sup> October 1999 over land comprised in LRV 1061 Folio 23 Plot 27 Margherita Road Kasese and two further charges dated 22<sup>nd</sup> January 2003 and 18<sup>th</sup> August 2003 respectively over the same land.

The lease facilities were also secured by a chattel's mortgage over the buses Reg. Nos. UAA 424C and UAA 069D. A finance law may therefore prescribe when a mortgage or other security is required to actualizing a lease transaction. In the same vein, *no-collateral requirements in leasing*, collateral / security is seldom required because the leased goods serve as security for the finance advanced. The lessor retains legal ownership over the asset, and in the event of default, the lessor can repossess the goods, a relatively straight forward process in most countries. In Tanzania,<sup>71</sup> however, repossession procedures have not been straight forward as lessees have often obtained court injunctions to prevent lessors from repossessing assets. *The rights and obligations of the parties were not balanced*<sup>72</sup>.

The details of the rights and obligations of the parties are not balanced. The lessor's obligations are limited by a fairly strict exoneration clause. The lessee is responsible for default by the settlement of paying capital goods rent along with late penalties, or withdrawal of capital goods by the lessor.

Under a finance lease, the equipment is selected by the lessee for purchase by a lessor financial institution and all implied representations and warranties by the lessor as to the quality of the equipment or fitness for the lessee's intended use are specifically excluded in the lease<sup>73</sup>. But the lease agreements do not provide for any warranties or remedy for the lessee from

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<sup>70</sup> CIVIL SUIT NO. 416 OF 2009

<sup>71</sup> The Tanzania Leasing Project ("TANZALEP") was officially launched on the 24th May, 2005.

<sup>72</sup> Lina Maulidiana, Implementation of Leasing Contract in Non-Banking Finance Institutions. European Research Studies Journal Volume XXI, Issue 4, 2018 pp. 255-267

<sup>73</sup> John F Varcoe, 'Finance Leasing-An Analysis of the Lessor's Rights upon Defaults by the Lessee' (1976) 1 Can Bus LJ 117

the supplier of a defective equipment for instance. This is because only a lessor who is the actual purchaser has such remedy from the supplier.

It is suggested that the future finance leasing law can consider setting a contract standard containing non-derogable rights and obligations. For instance on repossession the law must be explicit; in *Otaok Charles versus Equity Bank*,<sup>74</sup> the defendant argued the plaintiff did not have the right to sell the lease asset after repossession since the contract was silent on the same. Comparatively, under the Mortgage Act no. 8 of 2009, the right of foreclosure is streamlined and the attendant procedural obligations to be fulfilled.

This however does not extend to finance leases. There is no prescriptive procedure for termination nor valuation of the lease asset before selling the same. This shows the unequal bargain power of the lessor against the lessee. Even so, there is no duty of good faith to advertise the leased asset before sale.

The Uganda Law Reform Commission is called upon to study the contractual obligations of good faith for lessors such as the duty to advertise, the duty to provide notice, the duty to sell by public auction. A foreclosure example can be borrowed from Mortgage law in the decision of *Greenland Bank Ltd (in liquidation) versus Wasswa Birigwa and another*,<sup>75</sup> the court refused to accept as proper a sale inter alia because it was conducted by private treaty, without the benefit of competition that a public auction provides.

*The encroachment of leasing business on banker-customer relationship.* In another case of *Nassolo Farida versus DFCU Leasing Company Ltd* it involved the leasing company combining accounts of the plaintiff. The court considered the issue whether the bank's power of combining accounts is applicable to a lease contract. The Court held that a leasing company was not subject to banker-customer relationship, thus the lease company was not guided by the Finance Institutions Act. A finance lessor cannot combine accounts as a banking institution.

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<sup>74</sup> HCCS 335 of 2010

<sup>75</sup> High Court Civil suit no 26 of 2004

The general rule of law explicitly reserves the right of combination of accounts to banks only. On this basis, the statutory legal framework will need to specify which banker's duties are applicable to lease companies for instance the duty of confidentiality. In Uganda, most banking institutions have set up affiliated finance companies to carry on the leasing business separate from the banking business. The finance company is a nonbank Business Entity and Non-Bank Financial Institution specifically established to conduct activities which are included in the business field of the financing institution.

*Lack of standard of review for leases.* Illustratively, the case of *Gladys Nyangire Karumu versus Dfcu Leasing Company Limited & 3 Ors*<sup>76</sup> raised concern that the lease agreement is illegal for lack of statutory framework, that it was trying to circumvent the law namely the Sale of Goods Act<sup>77</sup> particularly sections 40 and 53 thereof. Section 40 of the Sale of Goods Act establishes the seller's lien where the sale of goods has been unpaid. It deals with the right to retain possession until payment.

The Court stated this law was inapplicable to the lease agreement. This decision left a void for the standard of review and clearly indicated that the parties are left to their bargain as the lease agreement will be a law unto itself. Absent a regulatory framework, every leasing contract may be determined on case by case basis. The judge-made law is apt to criticism for inconsistency and bias which limits growth of a coherent jurisprudence on the subject matter.

*The confusion in the tax treatment of lease payments and rental payments.* There is an ongoing debate whether finance lease payments are not deductible under Income Tax Act, and conversely that operating lease rental payments are deductible. In effect, all lease payments in respect of finance lease are not deductible for tax purposes; while rental payments in respect of operating leases are deductible expenses in light of Section 22 of the Income Tax Act.

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<sup>76</sup> HIGH COURT CIVIL SUITS NOS 106, 150 AND 788 OF 2007

<sup>77</sup> Repealed Act

The implementation of International Financial Reporting Standard (IFRS) 16<sup>78</sup> creates a vast uncertainty on the appropriate tax treatment of operating leases. This is due to the fact that IFRS 16 requires leases including (operating leases) of more than 12 months to be capitalized as a right of use asset and lease liability; yet the Income Tax Act has not yet been amended to reflect the new accounting standard. Instead the Act still reflects the position of (International Accounting Standards) IAS 17 that distinguished between finance leases and operating leases. This has raised uncertainty around the appropriate tax treatment.

The Parliament of Uganda could revise the application of (Value Added Tax) VAT so that it does not apply to lease payments for assets which, if purchased, would not be subject to VAT.

In Korea; the lessor registers the full lease payment (principal +interest) as income but deducts the accelerated depreciation of the assets. The lessee claims the lease payment (rentals) as deductible. The lease term is usually shorter than the economic life of the equipment, so the lessee in fact depreciates the equipment faster than if the asset was purchased. In Tanzania, the case is different. The lessee is the party entitled to claim depreciation and the interest portion of the lease rentals is registered as income to the lessors. Uganda Revenue Authority could also consider the application of lease payments as deductible and depreciation of the leased asset.

### ***3.3 Prospects for Capital formation through Asset-based Finance in leasing***

*Legal certainty is the basis of stable investment climates.* While making the decision about signing a leasing agreement, an entity needs to take into account the current legislation in force. It is the regulations that will have impact on the rights and obligations of the parties to the agreement, their tax charges and the requirements to be met by them.<sup>79</sup>

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<sup>78</sup> IFRS 16 is to report information that (a) faithfully represents lease transactions and (b) provides a basis for users of financial statements to assess the amount, timing and uncertainty if cash flows arising from leases.

<sup>79</sup> Wysłocka, E., Szczepaniak, W. 2012. The Effectiveness of Leasing as a Method of



Introducing a finance law to regulate leases could upset the investors' expectations. In *Philip Morris v. Uruguay case*, the tribunal stipulated that "the requirements of legitimate expectations and legal stability as manifestations of the Fair, Equitable Treatment standard do not affect the State's rights to exercise its sovereign authority to legislate and to adapt its legal system to changing circumstances."<sup>80</sup> Thus, introducing a finance leasing law is not encumbered by any investment legitimate expectations of investors.

#### **4.0 LEGISLATIVE REMEDIES AND GOVERNMENT REMEDIAL ACTION**

This paper fronts a proposal to establish a liability on the supplier for material defects<sup>81</sup>. Finance leasing requires that if goods under finance lease are found unsuitable or defective, the lessee should not be able to avoid the finance lease agreement with the lessor, but rather, should seek compensation from the supplier under the terms of the warranties attached to the goods. In Ghana<sup>82</sup>, the Act requires statement whether or not the prospective lessee has selected the asset and selected the supplier without relying on the skill and judgment of the prospective lessor.

Requiring that the lessee can enforce contractual obligations with regard to the goods directly against the supplier, as usually there will be no direct contractual relationship between the two parties. In Tanzania, the common law principle of privity to contract may prevent a lessee from taking direct action against a supplier of goods for lease. The lessees can be enabled to take direct action against suppliers in the event of supply of defective goods under a finance lease agreement.

Another key proposal is to assimilate both real property and personal property leases to the same general body of principles that serve to define a lease. Both types of leases perform similar economic functions, and there is

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Financing the Development of a Company. Polish Journal of Management Studies, 6, 129-142.

<sup>80</sup> Philip Morris Brands Sàrl et al. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7, Award, 422 (July 8, 2016) [hereinafter Philip Morris v. Uruguay]

<sup>81</sup> The private law can redistribute efficiently of the lessee can sue the supplier for a malfunctioning leased equipment

<sup>82</sup> S.1 (d) of the Finance Lease Act of Ghana

no good reason to define real property leases by one set of principles, and personal property leases by another<sup>83</sup>.

There should be extension of (*financial Institutions*) *Credit relief regulations* to finance leases. This will require the adoption of a finance lease as if it were financial loan subject to loan restructuring. Due to the Hell or high water clauses in a finance lease, there is a challenge that these lease contracts remain enforceable whether the equipment is out of service due to the COVID-19 pandemic yet the lessees are not protected<sup>84</sup>. This is because the lessee's duties towards the lessor become 'irrevocable'. In other words, the lessee becomes entitled to make rental payments specified in the lease and not to withhold rentals or to default on rental payments under any circumstances.

Uganda Law Reform Commission should carry out a study report on lease finance in Uganda. Indeed, a Consultation paper and Study Report on Lease Financing<sup>85</sup> in Uganda will suffice to establish the applicability of lease financing by distributors, car dealers, banks, suppliers and how leasing can be enhanced for international trade<sup>86</sup>. The Financial Institutions will need to guide Parliament to set up a legal policy on finance leasing to enable investment certainty<sup>87</sup>.

The Banking Associations and Investment Forums could guide the legislators on the feasibility of minimum payment clause for all failed finance leasing transactions as opposed to recovery of all future rental payments after termination of the lease agreement. All hire-purchase agreements contain a provision permitting the hirer to terminate the hiring

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<sup>83</sup> Merrill: The Economics of Leasing Downloaded from <https://academic.oup.com/jla/article/doi/10.1093/jla/laaa003/5904227> [accessed 9 July 2021]

<sup>84</sup> In Ghana, section 2 (1) (f) is a clause that the lessee confirms and acknowledges that the finance lease agreement is a full pay-out non-cancellable agreement and the lessee does not have a right to surrender the asset during the tenure of the finance lease agreement.

<sup>85</sup> To provide possibilities for foreign companies entering directly into a lease agreement with a Ugandan company

<sup>86</sup> This is intended to distinguish the leasing business by distributors of equipment and the dealership involved in selling the same equipment. It is common to find a seller of equipment being a lessor at the same time.

<sup>87</sup> Without a legal policy, the legislative framework may not be established on solid guidelines and public policy

and return the equipment to the owner upon payment as "compensation for depreciation" of a lump sum sufficient to pay the full purchase price, to bring the total payments made up to a fixed percentage of the purchase price. However, finance leasing does not have a minimum payment say, 70% of the actual future rental payments later on setting-off rights from the sale proceeds after repossession of the leased asset.

The Regulator (Bank of Uganda) should demand all lessors to be incorporated and registered and should comply with the laws of Uganda.

There should be an introduction of capital requirements-minimum threshold for leasing companies. The initial capital of the Lessor should be provided by its founders from their own funds, and it must be in pecuniary and non-pecuniary form. This is important because finance lease transactions could be fertile ground for money laundering and other illicit financial floors. In Serbia, the performance of financial leasing transactions that have immovable property as the lease asset, the pecuniary portion of the initial capital of the Lessor shall not be lower than the dinar equivalent of EUR 5,000,000 at the official middle exchange rate as at the payment date<sup>88</sup>.

The Bank of Uganda should require licensing of registered leasing companies. The Bank of Uganda could issue the license to engage in financial leasing based on the application of the Lessor's founder. In particular, the license for the establishment of a Leasing Company must obtain a business license from the Minister of Finance. In Uganda, there is some doubt as to whether nonfinancial companies may open shop for leasing finance. Thus, BOU should register and license leasing companies.

The Bank of Uganda should impose a limitation on lessors not to grant loans<sup>89</sup>. It is noted that the leasing transaction may be varied into a term loan due to lack of regulation. The financial regulator need step in to control the variation of lease contract into mortgages or loans if to do so would be unconscionable to the financial consumer. In Ghana, the Finance

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<sup>88</sup> Finance Leasing Act of Serbia

<sup>89</sup> This does not of course deter a Leasing company from assigning its lease to a financial institution which may convert the finance lease into a loan facility

Leasing Act empowers the Bank of Ghana to require lease finance companies to furnish the Bank with statements and information or particulars relating to the business of the finance lease in form and at the times specified by the Bank<sup>90</sup>.

The Insolvency practitioners should advise on the rights of the lessor in insolvency. To clarify circumstances where the rights of a lessor under this proposed Leasing law, may be enforced against a trustee in bankruptcy of the lessee, or against any creditor of a lessee, including any creditor who has obtained an attachment in execution of such equipment.

There should be provision for liability for Legal Defects to the Lessor for third-party rights that exist in relation to the Lease Asset which exclude, reduce or limit the Lessee's quiet possession, of which the Lessee was not informed, nor did the Lessee agree to accept the Lease Asset encumbered by such rights<sup>91</sup>. Both as to lessee and third party, claimants, the liability under a warranty should ultimately rest with the supplier. The lessee should benefit directly from any warranties by the supplier<sup>92</sup>.

The Uganda Registration Services Bureau (URSB) should introduce the finance leasing register under the Security in Moveable Property Act 2019. The Register of Financial Leases is a public register wherein, in accordance with the provisions of this Law, data on Lease Agreements concluded between natural and legal persons are recorded. In common law countries, registration of interests in leased assets constitutes notice to the public of the interests created by the parties whether or not third parties have had access to, and checked the registries<sup>93</sup>.

Uganda Revenue Authority should expand the tax shield of finance leases. The policy makers should increase tax shields for leasing products so as to enable growth of this investment in capital goods. In leases, the VAT payments on future rentals after repossession of equipment are compulsory.

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<sup>90</sup> S.14 (1) (a) and (b) on Powers of Bank of Ghana under the Finance Lease Act, 1993 P.N.D.C.L, 331

<sup>91</sup> Finance Lease Act of Tanzania, s.3(8) of the Finance Lease Act of Ghana

<sup>92</sup> Fairfax Leary Jr, 'The Procrustean Bed of Finance Leasing' (1981) 56 NYU L Rev 1061

<sup>93</sup> Section 6(1) of Finance Lease Act of Ghana requires a finance lease to be registered

The second schedule of the VAT Act which provides for exempt supplies includes the supply of financial services. However, under clause 2 (b) (iv) provision of credit facilities under leasing are specifically excluded from exemption and are liable to attract VAT. VAT was properly levied and paid on the future rentals.

For instance; under the Value Added Tax Act; Leasing is deemed as both a supply of goods and credit; therefore, leasing transactions are subject to VAT. An operating lease is considered to be a supply of services for VAT purposes; therefore, VAT is due on all rentals received by a lessor. Finance lease is a supply of goods and financial services (credit/loan). The Tax laws need to distinguish Repossession of goods as outside the scope of VAT as it is neither a supply of goods nor services.

## **5.0 CONCLUSION**

Uganda clearly has no discernible legislation or regulation for companies in finance leasing. This is in spite of the declaration that the private sector is the driver of its economic development. Uganda further lacks a competitive edge in the modern economic field due to capital-incentive-law on finance leasing.

Ugandan government must assess what is happening in other common wealth countries and regions with similar leasing laws. Knowledge of how such countries have fared with certain contract forms and fiscal regimes can shade light on the appropriateness of host country's proposed laws, contracts and fiscal regimes<sup>94</sup>. Thus, some form of comparative review is considered normal practice to achieve a uniform legislation.

The problem lies in the absence of specific legislation to regulate this type of financing such as leasing, which can be used by the Ugandan local investment companies, as industrial companies<sup>95</sup> need to finance some of their projects due to lack of financial liquidity for these establishment, which helps them improve their financial performance.

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<sup>94</sup> Dennis Kusasira, *supra*

<sup>95</sup> *ibid*

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