



Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg., EDSA, Greenhills, Mandaluyong City

12 July 2011

SEC-OGC Opinion No. **11-32**
Operating Lease; R.A. No. 8556

ATTY. EMMANUEL F. OCSING

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Dear Atty. Ocsing:

This refers to your letter dated 25 May 2011¹ seeking legal opinion whether an operating lease is covered by the thirty percent (30%) limit on extending credit to a single borrower.

The law applicable is Republic Act No. 8556 or the Financing Company Act of 1998² ("RA No. 8556"), which the Commission implements.³

Under Sections 3(c) of RA No. 8556 and 1(d) of its Implementing Rules and Regulations ("IRR")⁴, credit is defined as:

"(c) '*Credit*' shall mean any loan, mortgage, **financial lease**, deed of trust, advance or discount, any conditional sales contract, contract to sell, or sale or contract of sale of property or service, either for present or future delivery, under which, part of all or the price is payable subsequent to the making of such sale or

¹ Received by this Office on even date.

² Amending Republic Act No. 5980.

³ Section 4 of R.A. No. 8556 provides: "The Securities and Exchange Commission is hereby empowered to enforce the provisions implementing regulations except insofar as the Bangko Sentral may have supervisory authority under the provisions of Republic Act No. 7653 with respect to financing companies licensed to perform quasi-banking functions, and insofar as the Monetary Board has authority to prescribe financing company rates and charges under Sec. 5 hereof."

⁴ Published on 07 June 1999 and took effect on 22 June 1999.

contract; any contract, any option, demand, lien or pledge, or to the other claims against, or for the delivery of, property or money, any purchase, or other acquisition of or any credit upon the security of, any obligation or claim arising out of the foregoing, and any transaction or series of transactions having similar purpose or effect;"

Under the IRR, the total credit that a financing company may extend to any person, company, corporation or firm shall not exceed thirty (30%) of its network.⁵

The definition of credit under RA No. 8556 includes "financial leasing"⁶ - financial or capital lease: "a contract that transfers ownership of property to the lessee at the end of the lease term. (It is) a contract for the lease of property which possesses the characteristics of purchase."⁷ Essentially, a financial or capital lease gives the lessee almost as many rights to the use of the asset as if the lessee owned it. Assets acquired under such lease are treated as if these assets had been purchased.⁸

Likewise, noteworthy is the discussion of financial leasing in *Investor Finance Corp. vs. Court of Appeals*⁹:

"Thus, in a true "financial leasing," a finance company purchases on behalf or *at the instance of the lessee* the heavy equipment or machinery which the latter is interested to buy but has insufficient funds for the purpose. The finance company thereafter leases the equipment to the lessee in consideration of the periodic payment by the lessee of a fixed amount of "rental" sufficient to amortize at least 70%, of the acquisition cost of the equipment, including any incidental expenses and a margin of profit, over the lease period during which the lessee has the right to possess and use the leased equipment and to purchase it at the end of the lease period.

⁵ IRR, Section 9(d).

⁶ Sections 3(d) of R.A. No. 8556 and 1(e) of its IRR define 'financial leasing' as: "(a) mode of extending credit through a non-cancellable lease contract under which the lessor purchases or acquires, at the instance of the lessee, machinery, equipment, motor vehicles, appliances, business and office machines, and other movable or immovable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least seventy (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract."

⁷ Black's Law Dictionary (6th ed), 209 (1990).

⁸ Anthony, Robert, et al. Accounting: Text and Cases, 10th Ed, 232 (1999).

⁹ G.R. No. 91334, February 7, 1991.

Another form of financial leasing is when the seller or dealer of the heavy equipment leases it to the interested buyer who pays a fixed amount of "rental" sufficient to amortize at least 70% of the purchase price including any incidental expenses and a margin of profit.

In both cases, the purpose of the financial leasing transaction is to enable the prospective buyer of the heavy equipment, who cannot yet pay for it in cash, to lease it in the meantime for his use, at a fixed rental sufficient to amortize 70% of the acquisition cost including the expenses and a margin of profit, with the expectation that at the end of the lease period he will be able to pay the balance of the purchase price."

In addition to the aforementioned, a financial lease has different legal and tax treatment and implications from that of an operating lease. A financial lease involves payment over an obligatory period (primary or basic period which is non-cancellable) of a specified rental amount which is sufficient to amortize the capital outlay of the lessor and provide for his borrowing costs and profits. However, it is the lessee who exercises the choice of the asset and is normally responsible for the maintenance, insurance and such other expenses pertinent to the use, preservation and operation of the asset.¹⁰

On the other hand, an operating lease is "a lease agreement, usually cancellable, which provides the lessee with the use of an asset for a period of time which is considerably shorter than the useful life of the asset. **Unlike a capital lease, the lessee in an operating lease does not assume the economic risks of ownership, and the lessor generally provides all of the maintenance and services on the leased asset.**"¹¹ Moreover, operating leases are leases where the period of time leased is short relative to the total life of the asset.¹² Here, an asset is not wholly amortized during the primary period of the lease, and the lessor does not solely rely on the rentals during the said period for his profits. The lessor only seeks to recover the balance of his costs and the rest of his profits from the sale or re-lease of the returned asset at the end of the lease period.¹³

Notably, the definition of credit in R.A. No. 8556 does not include operating lease. Applying the principle of *expressio unius est exclusion alterius* where "the expression of one or more things of a particular class implies the exclusion of all not expressed",¹⁴ the exclusion of operating lease can only yield the legislative intent to restrict the meaning of "credit" to the items explicitly mentioned. Likewise, under the

¹⁰ See the discussion in: *Rafael S. Beltran vs. PAIC Finance Corporation*, G.R. No. 83113, May 19, 1992.

¹¹ Black's Law Dictionary (6th ed), 1091 (1990).

¹² See Note 8, *supra* at 231.

¹³ See Note 10, *supra*.

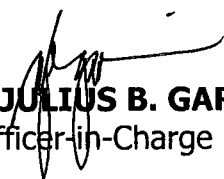
¹⁴ Agpalo, *Statutory Construction*, 223 (2003), citing cases.

rule of *casus omissus pro omisso habendus est*,¹⁵ the omission of operating lease from the definition of credit must be considered to have been omitted intentionally.

Thus, we confirm that the thirty percent (30%) limit in extending credit to a single borrower is not applicable to an operating lease.

The foregoing opinion rendered is based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission whether of similar or dissimilar circumstances.¹⁶ If, upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.


VESPER JULIUS B. GARCIA
Officer-in-Charge

¹⁵ See an illustration of the principle in *Sps. Nereo and Nieva Delfino vs. St. James Hospital, et al.* G.R. No. 166735, September 5, 2006.

¹⁶ SEC Memorandum Circular No. 15, series of 2003.