

## **Changes in the duty payable for the financing of leases**

From 2017 leasing companies performing real estate financing must also undertake to ensure as a condition of favourable duty of 2% that the lease agreement is performed. As of 1 January, the Act on Duties implicitly increased by 1% the former favourable duty rate of 2% applicable to closed-end lease agreements.

### **Open and closed-ended lease agreements**

In order to better understand the duty rules, it is worth reviewing at first which lease agreement is qualified as open-ended and as closed-ended. We talk about open-ended real estate financing lease agreement if it is uncertain whether the lessee acquires the ownership of the leased property at the end of the lease term or not. The Parties declare upon conclusion of the lease agreement that the lessee has a so called option to acquire the ownership title to the real estate at the end of the lease term: the lessee may decide not to acquire the ownership title to the real estate at the end of the lease term or may decide to do so; finally, he is also entitled to appoint another person for the acquisition of the ownership. In open-ended lease, the ownership status of the leased asset is floated till the end of the lease term. In contrast, in case of closed-ended lease, the parties already record upon conclusion of the agreement that the lessee automatically acquires the ownership of the leased asset at the end of the lease term. A further nature of real estate financing lease agreements is that the real estates to be financed are not in stock, the lessee will select them; subsequently, the lessor will purchase and make them available for financial leasing to the lessee on the basis of the type of the contract agreed by the Parties. From legal point of view, there are two sale and purchase steps in the business, which requires payment of duties in both cases.

### **Duties payable for all property acquisitions**

These two constructions differ from each other in terms of duty and tax legislation. The aspects of duty legislation are exclusively described in our present article. From duty point of view, both the sale and purchase of the lessor and the ownership acquisition of the lessee at the end of the lease term is encumbered with taxable capital transfer duty. When the lessor purchases the real estate targeted by the lessee, the lessor is required to pay taxable capital transfer duty. After the end of the term of the lease agreement, duties must be also paid after the ownership acquisition of the lessee or of a third Party appointed by him.



### **Allowance available only in case of closed-ended lease agreements**

The Act on Duties requires different duty rates for closed and open-ended leases. The rate of duties is calculated according to the general rules in case of the ownership acquisition by both the lessor and the lessee in open-ended leases. In contrast, the Act on Duties provides allowances to closed-ended leases, thus the lessor is entitled to claim duty of 2% rather than the general rate of 4%. The allowance is exclusively due to the lessor if certain requirements are met.

#### **Rules before 1 January 2017**

According to the rules before 1 January 2017, the lessor was entitled to favourable duty of 2% for the market value of the real estate provided that the lessor was qualified as a company performing financial lease under the authorization issued by the National Bank of Hungary, and undertook in a declaration to make the real estate available for financial lease resulting in the transfer of ownership within two years after the notification for imposing duties at the end of the lease term until the duty payment order issued by the National Tax and Customs Administration of Hungary becomes legally binding.

As stated above, it was sufficient to claim the allowance for entering into closed-ended lease agreement and to have this fact registered in the Land Registry.

#### **Rules after 1 January 2017**

According to the new rules, the lessor pays favourable duty of 3 % or 2% for the market value relating to the entering into the sale and purchase agreement. Duty of 3% - in accordance with the former rules – is only applicable if the lease company certifies the conclusion of the closed-ended financial lease agreement, and this fact is also registered by the Land Registry. Duty of 2% is exclusively applicable in the case when the lessor also **undertakes that the financial lease agreement will be performed**. If the lessee acquires the ownership, it is also considered as such according to the law.

If the Land Registry does not register the fact of the lease under the closed-ended lease or the lease agreement is not performed despite the undertaking of the leasing company, namely the lessee does not acquire ownership then the leasing company is subject to pay surcharge, the rate of which is double the margin between the duty (of 4%) generally payable and the duty (of 2%) actually paid. In case of a real estate with a market value of HUF 40 million, this penalty rate is HUF 1,600,000 on the duty of 2% already paid, namely above HUF 800,000 in the present case. Thus, it costs HUF



2,400,000 to the lessor if the lessee does not acquire ownership right despite of the undertaking of the lessor.

### **Legal concerns**

The law makes the favourable duty of 2% dependent on an uncertain future event. The real estate financing lease agreements mostly have a lease term of 10-15 years. In order to be able to use the duty of 2%, the lessor must undertake that the financial lease agreement will be performed during 10-15 years. This undertaking is problematic because there may be some circumstances - not imputable to the lessor-, which hinders in the performance of the agreement. The most frequent case is e.g. if the lessee does not fulfil his obligation to pay the lease fee, and thus the lease agreement will be terminated by the lessor, in which case it is not the lessee who acquires the ownership. This circumstance which is beyond the control of the lessor frustrates the performance of the agreement and thus the lessor is required to pay a surcharge. This new regulation of the Act on Duties also raises problems in terms of contract law. The lessor must practically undertake that the other Party, the lessee will duly perform and acquire the ownership at the end of the lease term.

### **Conclusions**

According to our standpoint, the leasing companies will carefully act in the future if they intend to price the sale and purchase with favourable duty of 2%. They must undertake in this case that the lease agreement will be performed following the end of the lease term, namely the lessee will acquire the ownership. The risk of using the duty of 2 % may also be transferred to the lessee. If the agreement will not be performed due to reasons imputable to the lessee, the lessee will be required to pay the surcharge imposed to the lessor. However, it is more likely that considering that the lease agreements mostly terminate due to non-payment by the lessee, the collection of the surcharge from the lessee also becomes dubious, thus the leasing companies will not assume this uncertainty in case of closed-ended leases, and will rather pay the duty of 3%.