

# LEASING

## CURRENT SITUATION

The development of leasing in Serbia is linked to the beginning of 2003 when the Law on Financial Leasing was adopted. Today, 17 leasing companies operate in Serbia, which are mainly affiliates of renowned financial institutions, leaders in the field of banking and financial operations in the markets of Central and Southeast Europe. These groups have implemented their knowledge and high corporate business standards in the Serbian market. As a result of market competition, the number of active leasing companies is expected to adjust to market needs and decrease in the following period. This will only bring the quality of the offer because the standard of leasing services that market leaders have implemented so far will be further confirmed.

## COVID-19

In the spirit of the measures and the Decision of the NBS to mitigate the consequences of the COVID-19 pandemic and preserve the stability of the financial system, leasing companies implemented a moratorium in settling obligations for all their clients. In addition, they granted additional benefits to help their clients, legal entities, entrepreneurs, and individuals, overcome the consequences of the new situation, as part of socially responsible business and care for their partners. This has brought new liquidity management challenges due to lower inflows, technical difficulties in adapting the system to the implementation of measures, and additional costs in adapting to new working conditions. However, leasing companies have successfully overcome new circumstances, trying to always be at the service of their clients.

## POSITIVE DEVELOPMENTS

In the previous period, during 2019, there were no significant improvements. The National Bank of Serbia did not initiate the adoption of amendments to the Law on Financial Leasing, yet in the meantime, certain analyzes of initiatives by the NBS and the Ministry of Finance have begun.

Regarding the recommendation related to the issuance of the Registration Authorization to Leasing Users, a series of working meetings were held between representatives of the Ministry of the Interior, BRA, and leasing companies and, according to the plan, by the end of 2020, delivery via web service will be provided which is a good improvement by applying digitalization in business.

## REMAINING ISSUES

### 1. Interest in financial leasing is still taxable

Law on Value Added Tax ("Official Gazette of RS", No. 84/2004, 86/2004 - amended, 61/2005, 61/2007, 93/2012, 108/2013, 6/2014 – coordinated RSD am., 68/2014 - other law, 142/2014, 5/2015 - coordinated RSD am., 83/2015, 5/2016 – coordinated RSD am., 108/2016 and 7/2017 - coordinated RSD am.), treats the products and services of financial institutions in different ways when defining the subject of VAT taxation.

Namely, in Article 4, item 2a) the Law clearly states that the supply of goods on the basis of a leasing contract is subject to VAT. According to the said Law, the basis for VAT is the value of the subject of leasing and interest.

On the other hand, the legislator provided in Article 25 of the same Law that credit operations and insurance services are exempt from VAT.

Different tax treatment of products and services of financial institutions has conditioned that financing through leasing in relation to other types of financing is more expensive, and therefore less favorable for certain segments of clients, given that VAT on interest is an additional cost, due to which financial leasing companies are put at a disadvantage. The best example of this effect was again observed by the NBS during the implementation of the measures prescribed by the NBS Decision on the Moratorium on Payment of Liabilities based on numerous customer complaints. Namely, the Decisions were made for both banks and leasing companies, and with their implementation, the clients of leasing companies who are not entitled to the previous VAT had an additional cost. It should not be forgotten that these are entrepreneurs, registered agricultural farms, and companies that are not in the VAT system.

### 2. Leasing companies are still charged for the cost of additional tickets, even though the users of the vehicle or lessees used the so-called services of public companies for parking service

Decisions on public parking lots of cities and municipalities in Serbia generally designate drivers or owners as users of public parking lots, if the drivers are not identified. These decisions further stipulate that if the users of the public parking lot violate the provisions of these decisions regard-

ing the non-payment of the parking ticket, they are obliged to pay the additional ticket. In cases when the vehicle is given in financial leasing, decisions on public parking lots do not take into account the business of financial leasing at all and consequently, additional tickets arrive for payment to leasing companies, although the users of these vehicles are recipients of financial leasing.

3. Operating leases are not regulated by law and financial leasing companies cannot deal with the provision of operating leases

The area of operating leasing is not regulated by special regulations, but exclusively by the Law on Obligations ("Official Gazette of SFRY", No. 29/78, 39/85, 45/89 - a decision of the CCY and 57/89, "Official Gazette of FRY", No. 31/93 and "Official Gazette of Serbia and Montenegro", No. 1/2003 - Constitutional Charter) in Chapter XI Lease, by the Ordinance on the criteria on the basis of which it is determined when the transfer of goods on the basis of a leasing contract or lease is considered ("Official Gazette of RS", No. 122/12) and a number of other legal acts that regulate in more detail the exploitation of rights and obligations in the field of the leased object (the subject of operating leasing). Operating leasing is by its nature (clients, suppliers, way of financing fixed assets, marketing strategy, etc.) much closer to financial leasing than the classic short-term lease. A concrete legal solution is needed for operating leasing in Serbia, above all supplements to the Law on Financial Leasing in the sense of enabling financial leasing companies to perform long-term lease activities within their activities, not only for items returned in the financial leasing business but also for newly acquired ones, which would be a sufficient reason for even more financial leasing companies to start with the provision of this type of service, i.e. products under the supervision of institutions responsible for financial leasing companies.

4. The high level of required capital for leasing companies for real estate leasing in the amount of EUR 5 million slows down the expected development of the leasing industry

The high level of required capital with other financial institutions (banks, insurance companies, or pension funds) is in line with the intention to provide security when managing clients' funds, while, unlike the mentioned ones, leasing companies manage their own funds and are not depository institutions, i.e. they invest their own capital and the entire

business risk is borne by the founder of the leasing company.

5. The guarantee fund may have a recourse claim from the leasing company for the damage caused using the item by the lessee

The Law on Compulsory Traffic Insurance stipulates that the Guarantee Fund of the Association of Insurers of Serbia has the right of recourse, upon payment of compensation from the owner of the means of transport, for the amount of damage, interest, and costs paid.

The Law on Compulsory Traffic Insurance is not harmonized with the Law on Financial Leasing, which introduced a legal deal into the legal system of the Republic of Serbia that, by definition and rules on liability for the use of leasing objects, conflicts with the existing rule on the recourse of the Guarantee Fund. The fact that the lessor is not able to influence the behavior of the lessee or other persons using the leased object and prevent the use of the vehicle in traffic without a compulsory insurance contract, as long as the leased object is located in the lessee's country, is completely ignored.

In the current situation, leasing companies face recourse claims from the Guarantee Fund of the Association of Insurers of Serbia, which they reject referring to the Law on Financial Leasing, while on the other hand the Guarantee Fund, despite understanding the essence of the dispute, has no legal possibility to apply for recourse to the paid amount of damage to any person other than the owner of the means of transport and possibly their driver, according to the system of subjective liability of the inflictor for damages.

6. Financial leasing is not included as a form of financing in some of the programs of state incentives in the economy

Financial leasing, as a type of financing, is not provided for in the Law on Incentives in Agricultural Production ("Official Gazette of RS", No. 10/2013, 142/2014 and 103/2015). Namely, Article 3, which regulates the types of incentives, provides for credit support, but not financial leasing, which prevents leasing companies from joining these programs along with banks. One of the conditions is that the fixed asset procured for the purpose of performing activities in agriculture must be exclusively owned by the recipient of the incentive, which by unilateral interpretation excludes

the purchase of that asset through a financial lease in which the financial leasing company would be the legal owner and the recipient of the incentive (the lessee) would be the economic owner. One of the conditions for obtaining an incentive is that the farmer must not alienate the fixed asset. The control of this condition is extremely complex and in reality difficult to apply by the authorities body, which would be prevented if the procurement of fixed assets with the help of incentives was carried out through financial leasing because special acts would stipulate that the recipient of the subsidy cannot repay and/or alienate fixed assets before the incentive, so the financial leasing company would receive the additional role of the controller on behalf of the competent authority.

A positive example is the Decrees of the Government of the Republic of Serbia on determining support to small enterprises for the procurement of equipment, which determines the Program of Support to Small and Medium Enterprises for the procurement of equipment. In addition to banks, this program also includes leasing companies and has been very successfully implemented.

7. Leasing companies and insurance companies are obliged to pay personal income tax in case of a write-off of receivables from natural persons

When a leasing company or insurance company makes a decision to write off claims from individuals who were previously sued, after an unsuccessful court procedure (due to poverty, inability to collect, etc.), they are obliged to calculate and pay personal income tax in the amount of 20%. Write-off receivables have the status of other income. This is defined by Article 85 of the Law on Personal Income Tax. Thus, a leasing company or an insurance company, in addition to having suffered a loss due to non-payment of obligations, has an additional obligation to pay personal income tax.

To make the paradox even bigger, this becomes the basis for the annual income tax of that natural person, so that a person who is unable to settle a debt to a leasing company or insurance due to poverty, can become a taxpayer if the value of the write-off together with other income exceeds the amount of 2.4 million dinars. This tax "illogicality" was noticed by the Ministry of Finance, and with the amendments to the Law on Personal Income Tax in 2013, an exception was made for banks as creditors. Other financial institutions that are also under the control of the NBS were then "forgotten".

8. The problem of the non-existence of criminal-legal protection of property of leasing companies.

As a precondition for the functioning of financial leasing as a financing model (in which leasing companies retain the right of ownership over financed objects), there is adequate and complete protection of financed leasing objects as assets of leasing companies. However, in addition to other obstacles facing the leasing industry in Serbia, a new obstacle has recently emerged that threatens to stifle leasing in Serbia. It is about the lack or complete absence of criminal legal protection of the property of the Financial Leasing Providers. Namely, the Supreme Court of Cassation in Judgment CA No. 42/16 dated 26 January 2016, took the position that in the case of evasion of the subject of financial leasing, there is no objective element of the criminal offense of evasion under Article 207 of the Criminal Code of RS, considering that the leasing contract by its nature leads to the acquisition of property rights, due to which non-compliance with contractual obligations falls within the domain of civil law and does not contain the essential elements of the said criminal offense. The Supreme Court of Cassation did not take into account that the civil law relationship has already been resolved by a court decision and that a contract that has been terminated can never lead to the acquisition of property rights. In the stated manner, the lessors of financial leasing in Serbia were deprived of the right to criminal-legal protection of their property contrary to the principles defined by the Constitution. If such a wrong position of the Supreme Court of Cassation continued to be applied by the competent public prosecutor's offices, rejecting criminal charges for the criminal offense of evasion of leasing objects, the result would certainly be a very rapid withdrawal of all leasing companies from the market of the Republic of Serbia. Also, the reaction to the mentioned Decision of the Supreme Court of Cassation can be a huge increase in the number of mentioned criminal acts, appropriation or alienation of other people's property in order to obtain illegal property gain, considering the absence of criminal sanction according to the practice taken by the Supreme Court of Cassation with the Judgment CA No. 42/16 dated 26 January 2016.

9. Within the term of the leasing contract, during the registration of the vehicle, the lessee must obtain special authorization from the leasing company every year to hold and use the leased object.

This document is a precondition without which the lessee cannot register the vehicle with the Ministry of the Interior. When obtaining this document, both the lessee and the leasing company are exposed to additional costs, as well as spending resources and time. Also, in practice, there was abuse and falsification of the said authority.

10. The current practice shows that vehicles that are on the warrant of the Ministry of the Interior, or whose registration has expired, are driven unhindered without authorization, until the moment when the police would stop them and do a detailed check.

Only then they would react to the search and seize the vehicle from the debtor, which is not a common case. Solving this problem would contribute to the protection of property, increase safety and legal security in the country, which, in addition to the general social significance, is also

important for the business of leasing companies and insurance companies.

We believe that the connecting of the Parking Service system and the Ministry of the Interior would significantly help legal security, because parking service workers while performing their activities (issuing an additional ticket or parking ticket), could see that the vehicle is on-demand or registration has expired, and the vehicle is being driven, after which they could call the representatives of the Ministry of the Interior and leave the towed vehicle in the police station until the dispute is resolved.

At the same time, the communal police, with a new method of recording traffic violations and illegal parking, can significantly contribute to a faster and more efficient finding of disputable leasing objects. Vehicle records through toll ways could help solve this problem.

### FIC RECOMMENDATIONS

- Initiation of amendments to the Law on Value Added Tax, in the part related to interest taxation, and in terms of revoking VAT on the part of leasing fee related to interest. (2)
- Amendment to the Law on Financial Leasing, which would explicitly transfer the obligation to pay for unpaid parking services to the lessee, and that this service legitimizes parking services to collect directly from lessees registered in the register of motor vehicles kept by the RS Ministry of Interior. Operating leasing should be regulated by the Law, i.e. financial leasing providers should be enabled to provide operating leasing services. (3)
- The Law on Compulsory Insurance in Traffic should be harmonized with the Law on Financial Leasing, in terms of the provisions on the right of recourse of the Guarantee Fund upon payment of damage caused by a vehicle for which a contract on compulsory insurance has not been concluded, by the owner or registered user of the vehicle, so that the insurance company can claim the recourse right from the lessee instead of from the leasing company. (1)
- When forming incentive programs in the economy (industry, agriculture, etc.) and drafting laws and bylaws that regulate this matter, it should be determined that incentives can be implemented with the support of financing, which, in addition to bank loans, also includes other types of financing, such as financial leasing. Given that financial leasing is also a suitable way of financing, it should be included in subsidized programs of the Government of the Republic of Serbia, which would improve competitiveness in the financial market and offer a more favorable type of financing. (2)
- Leasing and insurance companies should be in the same position as banks pursuant to Article 85 of the Law on Personal Income Tax, i.e. that in the case of a write-off of receivables they are not obliged to pay additional personal income tax if the conditions prescribed by law are previously met. The change would be to simply add "insurance company or lessor" next to the word "bank client". (2)

- The capital threshold for performing leasing, the subject of which is real estate, should be reduced in order to make real estate leasing more attractive on the Serbian market. We suggest that for performing financial leasing operations, the monetary part of the lessor's founding capital cannot be below EUR 500,000 in dinars (RSD) for both financial leasing of movable and immovable property (3)
- Urgent solution to the problem of criminal-legal protection of financed leasing objects. Consistent application of the Law in court proceedings conducted in this legal matter and acting in accordance with the Law and the Constitution of the RS. (2)
- It is necessary to enable leasing companies to submit the necessary data to the Ministry of the Interior through BRA (e.g. web service) and in that way, the lessee would be relieved of the obligation to obtain a vehicle registration authorization in writing once a year for delivery to the Ministry of the Interior during vehicle registration. In addition to the above, the proposed solution would put an end to the abuses that occur in practice with the submission of forgeries of these certificates. (1)
- Importing data from the Ministry of the Interior and the Parking Service in order to increase legal security in the country. (2)