

I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 15

April 8, 2005

1. Topic: Long-term leases on land and buildings

2. Issues: See DITEG Issue Paper # 15 Land and buildings owned by nonresidents on a long-term leasehold basis by IMF.

- (i) DITEG noted that the present manual and the Benchmark Definition do not provide guidance on the treatment of long-term leaseholds of land (and buildings).
- (ii) The group noted that determining the appropriate classification for the purchase of a long-term lease on land (and buildings) by a nonresident is based in whether that lease is equivalent to an operational or financial lease, that is, whether effective ownership has been transferred or not. The group felt the term of the lease was a secondary consideration.
- (iii) The group noted that it is possible for ownership of an asset to be split between two parties where long-term leases are involved. The group also noted the similarity between long-term leases in land (and buildings) and licenses for (most) broad band spectra. The group noted that, for these latter, the treatment in the national accounts is for the lessee to acquire an asset (representing the present value of the future income derivable over the life of the lease), but that, while the underlying value of the asset remains unchanged (assuming no price changes) over time, the value to the lessee falls and the value for the lessor rises as the license moves towards maturity. In principle, DITEG thought the same would apply for long-term leases on land (and buildings).
- (iv) The group discussed two examples of transactions in a long-term lease on land (and buildings), one between a resident and a nonresident, and a second between two nonresidents. The group came to the conclusion that whatever the residence of the transactors, the lease could not be identified as "other capital" because the land (and buildings) would be deemed to be owned by the (notional) direct investment entity (resident in the economy where the land is located, in the same manner as an outright purchase of land by a nonresident) and that it is the nature of the nonresident's claim on that direct investment entity that is the relevant consideration. Most members of the group felt that that investment would represent equity, which would fall in value as the lease moved to maturity (assuming no price changes).
- (v) DITEG took note that the question of how to treat a long-term lease that requires an annual (or periodic) land lease payment is to be discussed by Canberra II in March 2005. The group was advised that the new SNA will discuss finance leasing in more detail and be less focused on the length of the lease.

3. Recommendations:

- (i) DITEG recognized the existence of long-term leases on land (and buildings) and recommended that they need clarifying in the new balance of payments manual and the revised Benchmark Definition.
- (ii) DITEG felt that where an effective change in ownership takes place through a lease on land (and buildings), in a manner comparable to a finance lease, a notional enterprise should be created, in the same way it is when land (and buildings) are acquired outright. DITEG also felt that the claim on the direct investment entity should be considered to be equity and that the value of the asset would fall as the lease moves to maturity (assuming no price changes).
- (iii) DITEG did not think that an arbitrary rule regarding the length of the lease (to determine whether the lease represented an effective change of ownership or not) should be adopted, noting that an (original) term of one year seemed too short.
- (iv) DITEG felt that it would be appropriate to wait until Canberra II has held its meeting in April 2005 before making a final recommendation.

4. Rejected Alternatives:

Treating land (and buildings) acquired under a long-term lease by households for noncommercial purposes as “other investment”.

5. Questions for the IMF Committee on Balance of Payments (the Committee) and the OECD Workshop in International Investment Statistics (WIIS)

- (i) *Do the Committee and the WIIS agree that long-term leases on land (and buildings) need to be clarified in the new balance of payments manual and the revised Benchmark Definition? See 3(i).*
- (ii) *Do the Committee and the WIIS agree, where an effective change in ownership takes place through a lease on land (and buildings), in a manner comparable to a finance lease, that a notional enterprise should be created, in the same way as an outright purchase of land (and buildings)?*
- (iii) *And if they agree to the creation of a notional direct investment entity Question 2, do the Committee and the WIIS agree that the claim on that direct investment entity should be considered to be equity? See 3(ii) above.*
- (iv) *And if they agree to the treatment of the claim on the notional direct investment entity as equity (as per Question 3), do the Committee and the WIIS agree that the value of the asset would fall as the lease moves to maturity (assuming no price changes)? See 3(ii) above.*
- (v) *Do the Committee and the WIIS agree that an arbitrary rule regarding the length of the lease (to determine whether the lease represented an effective change of ownership or not) should not be adopted? See 3(iii) above.*

(vi) Do the Committee and the WIIS agree that it would be appropriate to wait until Canberra II has met (in April 2005) before making a final decision? See 3(iv) above.

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