

## IAS 17 Leases (March 2006)

### ***Leases of Land that do not transfer Title to the Lessee***

The IFRIC considered whether long leases of land would represent a situation when a lease of land would not *normally* be classified as an operating lease even though title does not transfer to the lessee.

IAS 17 states at paragraph 14 that a characteristic of land is that it normally has an indefinite economic life. If title is not expected to pass to the lessee by the end of the lease term, then the lessee *normally* does not receive substantially all of the risks and rewards incidental to ownership, in which case the lease will be an operating lease. Even when the land has an indefinite economic life, paragraph 15 states that ‘the land element is *normally* classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term.....’ [emphasis added].

The IFRIC noted that leases of land with an indefinite economic life, under which title is not expected to pass to the lessee by the end of the lease term, were classified as operating leases before an amendment to IAS 17 was made in respect of IAS 40 *Investment Properties*. Specifically, IAS 17 was amended to state that in leases of land that do not transfer title, lessees *normally* do not receive substantially all the risks and rewards incidental to ownership.

Some have understood the introduction of the word ‘normally’ as implying that a long lease of land in which title would not transfer to the lessee would henceforth be treated as a finance lease, since the time value of money would reduce the residual value to a negligible amount.

The IFRIC noted that, as summarised in paragraph BC 8, the Board considered but rejected that approach in relation to the classification of leases of land and buildings, because ‘it would conflict with the criteria for lease classification in the Standard, which are based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee’. The Board also made clear that it had not made any fundamental changes to the Standard.

The IFRIC noted that one example of a lease classification affected by the introduction of the word ‘normally’ was a lease of land in which the lessor had agreed to pay the lessee the fair value of the property at the end of the lease period. In such circumstances, significant risks and rewards associated with the land at the end of the lease term would have been transferred to the lessee despite there being no transfer of title. Consequently a lease of land, irrespective of the lease term, is classified as an operating lease unless title is expected to pass to the lessee or significant risks and rewards associated with the land at the end of the lease term pass to the lessee.

The IFRIC decided not to add this item to its agenda as, although leases of land that do not transfer title are widespread, the IFRIC has not observed, and does not expect, significant diversity in practice.