STAFF PAPER

May 2012

IFRS Interpretations Committee Meeting

Project	**IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 17 *Leases***
Paper topic	Purchase of right to use land

CONTACT(S) Kazu Sakaguchi ksakaguchi@ifrs.org +44 (0)20 7246 6930

Introduction

1. At the March 2012 meeting, the Interpretations Committee (the Committee) discussed a request to clarify whether the purchase of a right to use land should be accounted for as:
   (a) a purchase of property, plant and equipment;
   (b) a purchase of an intangible asset; or
   (c) a lease of land.
2. The Committee considered the staff analysis and proposal. The Committee identified characteristics of a lease in the fact pattern submitted and observed that a right to use land is generally accounted for under IAS 17. The Committee noted, however, that the ongoing Leases project is silent on whether a right-of-use asset is a tangible or an intangible asset, and that on the basis of the tentative decision made by the Board, long-term leases of land would not be excluded from the scope of the Leases project. Nevertheless, the Committee noted that the particular fact pattern considered is specific to a jurisdiction and the issue is therefore too narrow to address.

3. Accordingly, the Committee decided not to propose an amendment to IFRSs in respect of this issue, and asked the staff to bring back proposed wording to the next meeting for a tentative agenda decision.

4. This agenda paper is organised as follows:

   (a) Background information on the issue

   (b) Summary of comments made by the Committee at previous meeting

   (c) Appendix A—Proposed wording for tentative agenda decision.

Background information on the issue

5. In the fact pattern submitted, the laws and regulations in the jurisdiction do not permit entities to own freehold title to land. Instead, entities can purchase the right to exploit or build on land, for which agreement is made with the government. The right to make such an agreement is delegated to the government by the individual citizen.

6. Payment is made to the individual citizen through the government to purchase the right based on the fair value of the land. Once the entity purchases the right, the citizen will not retain any rights over the land and only the government can revoke the entity's right, and then only on the ground of public interest.

7. The right can be extended and renewed indefinitely at only an insignificant cost to be paid to the government. An entity has a legally protected right to obtain the extension/renewal, provided that all the legal and administrative requirements are met and that the land is not claimed by the government to be used for public interest purposes.

8. Adequate compensation will be provided for the assets (such as a building) on the surface of the land in any circumstances. However, compensation for the land based on the fair value will be provided only if the government revokes the entity's right during the period of right. No compensation will be provided for the land if the government revokes the entity's right when the period of the right has ended/expired or if the application to extend or renew the right is declined by the government.

9. The right can be used as collateral for debts and can be transferred to another party through sale, exchange, in-kind capital contribution, grant or inheritance.

Summary of comments made by the Committee at previous meeting

10. The Committee observed that, in the fact pattern considered, entities do not substantially own the land because the government has a right to reject the renewal. The Committee also observed that compensation for land would not be provided if the government revokes the entity's right when the period of the right has ended. The Committee was aware that expropriation could happen in other jurisdictions where entities are permitted to own freehold title to land, but noted that such entities would not have to renew their rights to the land in the first place if they own the land.

11. The Committee identified characteristics of a lease in the fact pattern considered, based on the definition of a lease, which is "*A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time*" (paragraph 4 of IAS17). Such characteristics are:

    (a) Right to use an asset: a right to use land is a right to use an asset.

    (b) Existence of lessor and lessee: an individual citizen is identified as a lessor, who is delegating the irrevocable right to the government, and the entity is a lessee. The Committee was informed that the government can sell the right to another entity if an entity does not extend or renew, and the land would revert to the original owner if the government does not find a buyer.

    (c) A payment or series of payments: payment to purchase the right is made to the individual citizen through the government.

    (d) Agreed period of time: there is an agreed period of time between the government and the entity including renewal options. The Committee specifically noted that a lease could be indefinite with extensions or renewals and that, therefore, the existence of indefinite period itself does not prevent the right to use from being accounted for as a lease in accordance with IAS 17.

12. The Committee acknowledged that in some jurisdictions entities account for a right to use land as either an intangible asset or as a property, plant and equipment. The Committee noted, however, that a right to use land is generally accounted for under IAS 17 and that such a right would be classified as a finance lease if it met the criteria described in paragraph 4 of IAS 17 (assets leased under finance leases would be disclosed according to each class of asset).

13. The Committee noted the ongoing Leases project. The Committee did not find a reasonable ground to provide guidance on the issue at this stage, given that the Leases project is silent on whether a right-of-use asset is a tangible or an intangible asset. In addition, the Committee considered the tentative decision made by the Board that long-term leases of land would not be excluded from the scope of the Leases project (refer to IASB *Update* of April 2010).

14. The Committee, notwithstanding such observations, noted that the particular fact pattern considered at the meeting is specific to a jurisdiction and thus it is too narrow to undertake the due process associated with an interpretation or an annual improvement.

15. Consequently, the Committee decided not to take this issue onto its agenda.

Proposed wording for tentative agenda decision

16. The staff drafted tentative agenda decision (see Appendix A) based on the Committee's request, also taking into consideration the comments made by the Committee at the previous meeting.

Question to the Committee
Does the Committee agree with the proposed wording for tentative agenda decision in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 17 *Leases*—Purchase of right to use land

In January 2012, the IFRS Interpretations Committee (the Committee) received a request to clarify whether the purchase of a right to use land should be accounted for as:

-a purchase of property, plant and equipment;

-a purchase of an intangible asset; or

-a lease of land.

In the fact pattern submitted, the laws and regulations in the jurisdiction do not permit entities to own freehold title to land. Instead entities can purchase the right to exploit or build on land. According to the submitter, there is diversity in practice on how to account for a land right in the jurisdiction concerned.

The Committee identified characteristics of a lease in the fact pattern considered, based on the definition of a lease. The Committee specifically noted that a lease could be indefinite with extensions or renewals and that, therefore, the existence of an indefinite period does not itself prevent the right to use from being accounted for as a lease in accordance with IAS 17.

The Committee acknowledged that some jurisdictions account for a right to use an asset either as an intangible asset or as a property, plant and equipment. The Committee noted, however, that a right to use land is generally accounted for under IAS 17 and that such a right would be classified as a finance lease if it met the criteria described in paragraph 4 of IAS 17.

The Committee noted the ongoing Leases project, which is silent on whether a right-of-use asset is a tangible or an intangible asset. In addition, the Committee took into consideration the tentative decision made by the Board that long-term leases of land would not be excluded from the scope of the Leases project.

The Committee, notwithstanding such observations, noted that the particular fact pattern considered is specific to a jurisdiction and thus concluded not to develop an interpretation or an annual improvement.

Consequently, the Committee [decided] not to take this issue onto its agenda.