

STAFF PAPER

16–17 July 2013

IFRS Interpretations Committee Meeting

Project	IAS 40 <i>Investment Property</i>
Paper topic	Accounting for a structure that appears to lack the physical characteristics of a building
CONTACT(S)	Kenichi Yoshimura kyoshimura@ifrs.org +44 (0)20 7246 6905

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. The IFRS Interpretations Committee (‘the Interpretations Committee’) received a request to clarify whether telecommunication towers in a jurisdiction should be accounted for as property, plant and equipment (PP&E), in accordance with IAS 16 *Property, Plant and Equipment*, or as investment property, in accordance with IAS 40 *Investment Property*. The request describes a circumstance in which an entity owns telecommunication towers and receives rent revenue in exchange for leasing spaces in the towers to telecommunication operators, to which they attach their own devices.
2. Key physical characteristics of the telecommunication towers described in the submission are that the towers (a) do not have walls, floors, or a roof (they consist only of steel frames) and (b) are permanently constructed on a piece of land (it would require significant costs to dismantle, relocate, and reconstruct them). The entity provides some basic services to the telecommunication operators such as maintenance services. The leasing of spaces in the telecommunication tower is an emerging business model.
3. In this request, the submitter is specifically seeking a clarification on:

- (a) whether a telecommunication tower should be viewed as a ‘building’ and thus as ‘property’, as described in paragraph 5 of IAS 40; and
 - (b) how the service element in the leasing agreement and business model of the entity should be taken into consideration when analysing this issue.
4. In the September 2012 meeting, the Interpretations Committee agreed that the telecommunication tower in the submission has some of the characteristics of investment property, in that spaces in the tower are let to tenants to earn rentals. However, the Interpretations Committee expressed concerns as follows:
- (a) it is questionable whether the tower qualifies as a ‘building’ because it lacks features usually associated with a building, such as walls, floors and a roof; and
 - (b) the same question could arise about other structures, such as gas storage tanks and advertising billboards.
5. Consequently, the Interpretations Committee requested the staff to perform further analysis on this issue so that the Interpretations Committee can consider whether amendments to the scope of IAS 40 could or should be made.
6. In the January 2013 meeting, the Interpretations Committee was provided with updates on the staff analysis on whether and how IAS 40 could be amended to expand the scope of IAS 40 to also include a structure that lacks the physical characteristics associated with a normal building. In the discussions, the Interpretations Committee observed that there is merit in exploring approaches to amending IAS 40 to help the IASB to decide whether IAS 40 should in fact be amended so that the scope of IAS 40 is not limited to land and buildings. This would be in order to accommodate emerging business models such as leasing of spaces in telecommunication towers. The Interpretations Committee discussed whether the scope of IAS 40 might be more meaningful if it focused on the nature of the business activity (and therefore might include assets other than property

that are held to earn rentals or for capital appreciation or both) rather than on the nature of the asset.

7. However, the Interpretations Committee also noted that under the new proposed lease accounting model, the guidance for deciding (a) how a lessor accounts for a lease, and (b) how a lessee recognises lease related expenses in profit or loss, depends, to a large extent, on whether the lease is a lease of property or a lease of an asset other than property. In this regard, the Interpretations Committee was concerned about whether the meaning of the term ‘property’ should be consistent with its meaning in the new lease accounting model.
8. On the basis of the discussions above, the Interpretations Committee directed the staff to inform the IASB of the views expressed in this meeting when the IASB deliberates the Leases project, and to seek the IASB’s views as to what extent the IASB think the definition of the term ‘property’ in IAS 40 should be aligned with that in the new Leases Standard.
9. Accordingly, in this Agenda Paper, we are providing the Interpretations Committee with the updates on the IASB’s discussions in the Leases project and our analysis on how to proceed with this issue.
10. This agenda paper is organised as follows:
 - (a) updates on the Leases project;
 - (b) proposed amendments to IAS 40;
 - (c) application of the amended definition of investment property to example transactions;
 - (d) staff recommendation; and
 - (e) questions for the Interpretations Committee.

Updates on the Leases project

11. At the January 2013 joint board meeting, the IASB was provided with the summary of the views expressed in the meetings of the Interpretations Committee with regard to the definition of the term ‘property’ in IAS 40. However, the IASB reconfirmed its previous decision that, in the *Leases* Exposure Draft that was published in May 2013, ‘property’ should be defined consistently with the existing definition of property in IAS 40 (ie land or a building—or part of a building—or both).

12. We now know that the IASB decided not to propose a definition of the term ‘property’ that is different from that in the current definition in IAS 40 at this stage of the Leases project. However, as stated in the previous meetings, we think that the Interpretations Committee should propose amendments to the definition of the term ‘investment property’ in IAS 40 in order to accommodate emerging business models such as leasing spaces in telecommunication towers. We are of the view that the telecommunication tower described in the submission should be accounted for consistently with a building if it is held to earn rentals and generates cash flow largely independently of other assets held by the entity. In addition, we note that the Interpretations Committee recognises the merit in expanding the scope of investment property to accommodate such an emerging business model.

13. Accordingly, if the Interpretations Committee agrees that improvements could be made to the definition of investment property in IAS 40, we think that the Interpretations Committee should develop the amendments independently of the Leases project so that the IASB could consider them when finalising the new Leases Standard.

14. In the following paragraphs, we will discuss how the definition of investment property could be amended for the purpose of IAS 40.

Proposed amendments to IAS 40

Characteristics of investment property

15. We are of the view that whether an asset meets the definition of investment property in IAS 40 should not be determined solely on the basis of the physical nature of the asset, such as whether it has walls, floors, or a roof. We understand that the Interpretations Committee agreed with this view in the previous meetings. As stated in Agenda Paper 14 of the Interpretations Committee meeting in January 2013, we think that the focus of IAS 40 is on the asset's characteristic that **it generates cash flows largely independently of the other assets held by the entity** (paragraph 7 of IAS 40). Consequently, we think that this criterion should remain as one of the key criteria to determine whether an asset should be accounted for as investment property in accordance with IAS 40.

16. In addition to the characteristic stated above, another key characteristic implied in the definition of investment property in IAS 40 is that, in our view, the location of investment property has a significant bearing on its value. We think that this characteristic arises from the inherent nature of property, which is that the location of property significantly differentiates it from other property.

17. A normal office building is built on land in a specific location and is not expected to be moved. If a building is moved to a different place, the building no longer generates future cash flows in the manner originally intended even if the physical characteristics remain the same. This is because the location of the land where a building is situated dictates to a large extent its ability to generate future cash flows. This characteristic clearly distinguishes land and a building from a readily movable asset (eg machinery, car, ship, aircraft), which is intended to be movable and from which future cash flows are not significantly affected by the location of the land on which that asset is situated.

18. Consequently, for the purpose of IAS 40, we think that investment property should also include, in addition to land and a building, any physical structure **if**

the future cash flows to be earned from the structure depend largely upon the location of the land to which the structure is attached directly or indirectly.

19. In summary, we think that investment property should be defined by the characteristics as follows:
- (a) **it is held to earn rentals or for capital appreciation or both;**
 - (b) **future cash flows to be earned from it depend largely upon the location of the land to which it is attached; and**
 - (c) **it generates cash flows largely independently of other assets held by the entity (ie it is not owner-occupied property).**

Proposed wording of the amendments

20. On the basis of the discussions above, we think that the definition of the term ‘investment property’ should be amended in the following manner (new text is underlined):

5. [...]

Investment property is a property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes; or
- (b) sale in the ordinary course of business.

For the purpose of this Standard, the term ‘property’ includes land, and includes a building or other physical structure (or part of a building or other structure) if the future cash flows to be earned from the structure depend largely upon **the location of the land to which the structure is attached directly or indirectly.** Structures that are readily movable are not considered property for the purpose of this Standard.

21. When deciding whether a structure is investment property in IAS 40, under the amended definition of investment property, an entity first assesses whether it is held to earn rentals or for capital appreciation or both. The entity then assesses

the structure against the criterion that the location of the land to which the structure is attached a key part of its value. If so, the entity moves on to the third step, which is to assess whether the structure is owner-occupied property or not (paragraph 11 of IAS 40), namely, whether the structure generates cash flows largely independently of other assets held by the entity (paragraph 7 of IAS 40). This process would be the same as that required by the existing requirements in IAS 40 except that the scope of the term ‘investment property’ is expanded to include a structure, the value of which is significantly affected by the location of the land to which the structure is attached.

Application of the amended definition of investment property to example transactions

22. The following table shows whether different types of structures would be within the scope of IAS 40 under the revised definition of ‘investment property’, assuming that the owner of the structure owns the structure to earn rentals for leasing the structure to other entities.

#	Structures and equipment	Property?	If property, is it investment property? (owner-occupied?)
1	Telecommunication tower/advertising billboard	<p>Generally yes</p> <ul style="list-style-type: none"> • The location is determined by factors specific to the area (eg levels of signals, traffic). • If its location was different, future cash flows to be earned from the structure could change significantly. • Thus, the value of the structure is significantly affected by the location of the land to which it is attached. 	<p>Generally yes</p> <ul style="list-style-type: none"> • It is used for earning rentals by leasing space in or on it. • However, it would be viewed as owner-occupied if the owner provides significant ancillary services.
2	Warehouse	<p>Generally yes</p> <ul style="list-style-type: none"> • The location is determined by factors specific to the 	<p>Generally yes</p> <ul style="list-style-type: none"> • It is used for earning rentals by leasing space in or on it.

#	Structures and equipment	Property?	If property, is it investment property? (owner-occupied?)
		<p>area (eg proximity to a city, port, plant etc).</p> <ul style="list-style-type: none"> • If its location was different, future cash flows to be earned from the structure could change significantly. • Thus, the value of the structure is significantly affected by the location of the land to which it is attached. 	<ul style="list-style-type: none"> • However, it would be viewed as owner-occupied if the owner provides significant ancillary services (eg quality maintenance, transport, inventory management).
3	Oil/gas storage tank	<p>Generally yes</p> <ul style="list-style-type: none"> • The location is determined by factors specific to the area (eg proximity to a city, port, plant etc). • If its location was different, future cash flows to be earned from the structure could change significantly. • Thus, the value of the structure is significantly affected by the location of the land to which it is attached. 	<p>Generally yes</p> <ul style="list-style-type: none"> • It is used for earning rentals by leasing space in or on it. • However, it would be viewed as owner-occupied if the owner provides significant ancillary services (eg quality maintenance, transport, inventory management).
4	Power plant	<p>Generally yes</p> <ul style="list-style-type: none"> • The structure is connected to a specific power grid. • Its location might also be affected by the convenience in procuring fuel used to generate power. • If its location was different, future cash flows to be earned from the structure could change significantly. • Thus, the value of the structure is significantly affected by the location of the land to which it is attached. 	<p>Generally no</p> <ul style="list-style-type: none"> • It is used for generating power (eg in a take-or-pay arrangement) rather than earning rentals by leasing spaces in or on it. • However, if it is held for earning rentals (eg if an entity leases the entire structure to a third party with no, or insignificant, involvement in the operation), it would be viewed as investment property.
5	Stadium	<p>Generally yes</p> <ul style="list-style-type: none"> • The structure is built in an area suitable for events it is intended to house. 	<p>Generally no</p> <ul style="list-style-type: none"> • It is used for providing services of hosting entertainments rather than

#	Structures and equipment	Property?	If property, is it investment property? (owner-occupied?)
		<ul style="list-style-type: none"> • If its location was different, future cash flows to be earned from the structure could change significantly. • Thus, the value of the structure is significantly affected by the location of the land to which it is attached. 	<p>earning rentals.</p> <ul style="list-style-type: none"> • However, if it is held for earning rentals (eg if an entity leases the entire structure to a third party with no, or insignificant, involvement in the operation), it would be viewed as investment property.
6	Pipeline/fibre optic cable	<p>Generally yes</p> <ul style="list-style-type: none"> • The structure connects multiple points of location. • If its location was different, future cash flows to be earned from the structure could change significantly. • Thus, the value of the structure is significantly affected by the location of the land to which it is attached. 	<p>Generally no</p> <ul style="list-style-type: none"> • It is used for providing services of transporting commodities or data of customers rather than earning rentals. • However, if it is held for earning rentals (eg if an entity leases the entire structure to a third party with no, or insignificant, involvement in the operation), it would be viewed as investment property.
7	Cargo ships/cargo planes	<p>Generally no</p> <ul style="list-style-type: none"> • The structure is not intended to be used in a specific location. • It is readily movable. • Even if its location was different, the future cash flows would not change significantly. • Thus, the value of the structure is not significantly affected by its location. 	N/A
8	Automobiles	<p>Generally no</p> <ul style="list-style-type: none"> • The structure is not intended to be used in a specific location. • It is readily movable. • Even if its location was different, the future cash flows would not change 	N/A

#	Structures and equipment	Property?	If property, is it investment property? (owner-occupied?)
		significantly. <ul style="list-style-type: none"> • Thus, the value of the structure is not significantly affected by its location. 	

Examples 1-3

23. With regard to the structures in Examples 1-3 (eg telecommunication towers, warehouses, oil storage tanks), the value of the structure could be significantly affected if its location was changed. This is because the patterns of cash flows generated from the structure depend on factors specific to the location of the land on which it is built. For example, the location of the land for a telecommunication tower is determined on the basis of levels of network signals available in a specific area. If the location was changed, the telecommunication tower would not generate cash flows in the manner originally intended. Accordingly, we think that those structures should be accounted for as investment property if other criteria are met.

24. As stated in the table above, we are of the view that those structures usually generate cash flows largely independently of other assets held by the entity if they are held to earn rentals or capital appreciation or both. However, the owner of the telecommunication tower may provide significant services using the tower such as broadcasting services. An owner of warehouses may also provide high quality inventory management services for customers while letting the customers use space in them. In those cases, the entity is likely to conclude that the structure should be accounted for in accordance with IAS 16 rather than IAS 40 because cash flows from the structure significantly depend on other assets held by the entity.

Examples 4-6

25. We think that structures such as a power plant, stadium and pipeline would be viewed as property under the proposed definition of investment property. This is because, for example, if a power plant is located on land in a different location, it might not be able to be used in the manner originally intended, because a power plant is connected to a specific power grid in an area. In addition, in some cases, the location of a power plant is determined primarily on the basis of the convenience of fuel transportation. For a stadium, cash flows generated from it could be significantly changed depending on the location of the land on which it is built, because events to be hosted by the stadium are generally area-specific and dependent on the location of the stadium.
26. We think however that the way in which these assets are typically used would lead the owners of the assets to classify them as owner-occupied property. The owner of pipelines typically uses the structure for providing services of transporting commodities of customers from one location to another rather than simply leasing space in the structure. On the other hand, if the entity leases the entire structure with no, or insignificant, further involvement in the operation of the structure (eg the entity leases the entire stadium to a sports team and does not provide significant ancillary services), the structure would be classified as investment property.

Examples 7 and 8

27. The asset is not intended to be used in a specific location. The value of the asset would not change significantly even if it is moved to a different location because it functions as originally intended largely independently of its location. Instead, in many cases, the mobility of those assets is a key part of their value. In that sense, those assets are significantly different from a normal building and therefore should not be accounted for as investment property.

Staff recommendation

- 28. We are of the view that the definition of investment property should be amended to ensure that structures that are used for similar transactions are accounted for in a consistent manner regardless of their physical nature. We think that the amendment should be in line with the key features of investment property described in paragraph 19 of this Agenda Paper.

- 29. As stated earlier, the IASB has published the *Leases* Exposure Draft in May 2013. The Exposure Draft uses the same definition of property as in IAS 40.

- 30. We think that the Interpretations Committee should move forward and propose an approach to amending IAS 40 so that, when the IASB discusses comments received on the Leases Exposure Draft, it can consider whether the Leases Standard should include a definition of ‘property’ that is consistent with any amended definition of investment property in IAS 40.

- 31. Accordingly, the Interpretations Committee should proceed to develop an amendment to IAS 40 based on the proposed amendment in paragraph 20 of this Agenda Paper, and recommend to the IASB that it should consider the proposed amendment not only within the context of IAS 40, but also within the context of the new Leases Standard in the comment letter analysis phase of the Leases project.

Questions for the Interpretations Committee

Question 1

Does the Interpretations Committee agree with the staff recommendation that it should develop an amendment to IAS 40 and recommend to the IASB that it should consider the proposed amendment when finalising the

Leases Standard?

Question 2

If the answer to Question 1 is yes, does the Interpretations Committee agree with the proposed amendment to the definition of investment property in IAS 40?

Question 3

If the answer to Question 2 is no, what alternatives does the Interpretations Committee recommend and why?