IFRS

STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Non-refundable Value Added Tax on Lease Payments (IFRS 16)**
Paper topic	Comment letters on tentative agenda decision

CONTACT Gustavo Olinda golinda@ifrs.org +44 (0) 20 7246 6481

Introduction

1. In March 2021, the IFRS Interpretations Committee (Committee) published a tentative agenda decision in response to a submission about how a lessee accounts for any non-refundable value-added tax (VAT) charged on lease payments. In the fact pattern described in the submission:

   (a) the lessee operates in a jurisdiction in which VAT is charged on goods and services. A seller includes VAT in an invoice for payment issued to a purchaser. In the case of leases, VAT is charged when an invoice for payment is issued by a lessor to a lessee.

   (b) the applicable legislation:

      (i) requires a seller to collect VAT and remit it to the government; and

      (ii) generally allows a purchaser to recover from the government VAT charged on payments for goods or services, including leases.

   (c) because of the nature of its operations, the lessee can recover only a portion of the VAT charged on purchased goods or services. This includes VAT charged on payments it makes for leases. Consequently, a portion of the VAT the lessee pays is non-refundable.

(d) lease agreements require the lessee to make payments to the lessor that include amounts related to VAT charged in accordance with the applicable legislation.

2. The request asked whether, in applying IFRS 16 *Leases*, the lessee includes non-refundable VAT as part of the lease payments for a lease.

3. Outreach conducted by the Committee provided limited evidence:

(a) that non-refundable VAT on lease payments is material to affected lessees; and

(b) of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

4. The Committee therefore noted that it had not yet obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan.

5. The objective of this paper is to:

(a) analyse comments on the tentative agenda decision (paragraphs 7–28); and

(b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision (paragraph 29).

6. Appendix A to this paper sets out the proposed wording of the agenda decision.

Comment letter summary

7. We received 16 comment letters by the comment letter deadline. All comments received, including any late comment letters, are available on our website.[1] This

[1] At the date of posting this agenda paper, there were no late comment letters.

agenda paper includes analysis of only the comment letters received by the comment letter deadline, which are reproduced in Agenda Paper 2A.

8. The following paragraphs summarise respondents’ comments on:

   (a) the Committee’s decision not to add a standard-setting project to the work plan;

   (b) the prevalence of the matter and diversity in the way entities account for non-refundable VAT on lease payments; and

   (c) the accounting in the fact pattern described in the tentative agenda decision.

Agreement with the tentative agenda decision

9. Most respondents agree with the Committee’s decision not to add a standard-setting project to the work plan. Some of these respondents suggest that the agenda decision explain the accounting lessees apply to non-refundable VAT on lease payments. In their view, explaining the accounting a lessee applies would reduce any existing diversity and prevent new diversity from arising. These respondents, however, express differing views on the accounting they suggest the agenda decision should explain (see paragraph 13).

10. Some respondents neither agree nor disagree with the tentative agenda decision. Instead, these respondents provide information about the tax legislation in their jurisdiction or share their views on the accounting.

Prevalence and diversity

11. Some respondents say non-refundable VAT on lease payments affects many lessees in different jurisdictions and sectors (such as banking and insurance). However, these respondents do not comment on the materiality of non-refundable VAT for affected lessees, except for one respondent that says the matter could be material and another respondent that says the matter is generally immaterial for lessees in its jurisdiction.

12. Almost all respondents do not comment on whether there is diversity in the way lessees account for non-refundable VAT. Two respondents say diversity may or is

likely to exist; another respondent says there is no evidence of diversity in its jurisdiction.

Views on the accounting

13. Many respondents share their views on the accounting. A few respondents support no particular accounting treatment, while others support either including, or excluding, non-refundable VAT as part of lease payments for a lease. The main reasons provided in support of these views are as follows:

    (a) respondents that say non-refundable VAT should be excluded from lease payments generally support this view by saying that such payments do not constitute a payment to the lessor, but to the tax authority. The lessor acts only as a collecting agent on behalf of the tax authority and, therefore, the lessee does not make such payments to the lessor in exchange for the right to use the underlying asset. For this reason, non-refundable VAT does not meet the definition of lease payments.[2] Instead, they say payments of non-refundable VAT meet the definition of a levy in IFRIC 21 *Levies*, and lessees should account for such payments accordingly.

    (b) respondents that say non-refundable VAT should be included as part of lease payments generally support this view by referring to paragraph 16(a) of IAS 16 *Property, Plant and Equipment*. Paragraph 16(a) of IAS 16 requires an entity to include 'non-refundable purchase taxes' as part of the cost of an item of property, plant and equipment. A few of these respondents comment on whether entities would account for non-refundable VAT as variable lease payments or whether a part (or all) of these payments would be in-substance fixed payments. One respondent says lease contracts oblige lessees to make payments that include non-refundable VAT—the fact that the lessor might be acting as a collecting agent on behalf of the tax authority does not change the lessee's obligation to make payments under the contract.

[2] Appendix A to IFRS 16 defines lease payments as 'payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term…'.

14. Respondents' support for the two views are similar to those identified in the initial outreach or provided in the submission. The Committee considered these arguments at its meeting in March 2021.[3]

Staff analysis

Does the mater have widespread effect and has, or is expected to have, a material effect on those affected?

15. Feedback on the tentative agenda decision in our view provides little additional evidence:

    (a) that non-refundable VAT on lease payments is material to affected lessees; or

    (b) of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

16. Although some respondents express differing views on the accounting and many state that fact patterns such as the one described in the tentative agenda decision are widespread, respondents do not report observing significant diversity in the accounting lessees apply, nor do they report that the matter is generally material for affected lessees.

17. Therefore, in our view, the information provided by respondents in comment letters—together with information the Committee obtained from the initial outreach—provides insufficient evidence to suggest that the matter described in the submission has 'widespread effect and has, or is expected to have, a material effect on those affected'. Consequently, in our view the criterion in paragraph 5.16(a) of the *Due Process Handbook* (see paragraph 18 of this paper) is not met.

Should the Committee explain the accounting in an agenda decision?

18. Paragraph 5.16 of the *Due Process Handbook* sets out the criteria the Committee considers when deciding whether to add a standard-setting project to the work plan. Paragraph 5.16 states that *all* the criteria listed in that paragraph must be met for the Committee to decide to add a standard-setting project to the work plan. Consequently,

[3] See Agenda Paper 3 for that meeting.

failure to meet any one of the criteria is sufficient for the Committee to decide not to add a standard-setting project.

19. One criterion in paragraph 5.16—included in sub-paragraph 5.16(a)—is that 'the matter has widespread effect and has, or is expected to have, a material effect on those affected'. As explained above in paragraphs 15–17, in our view this criterion is not met with respect to the submission discussed in this paper.

20. Paragraph 8.3 of the *Due Process Handbook* states that:

> …An agenda decision typically includes explanatory material when the reason for not adding a standard-setting project to the work plan is the Interpretations Committee's conclusion that the principles and requirements in the Standards provide an adequate basis for an entity to determine the required accounting…

21. This means that an agenda decision typically includes explanatory material when the criterion in paragraph 5.16(b) of the *Due Process Handbook* is not met.[4]

22. In our view, the Committee's role is not to undertake technical analysis and provide explanatory material in agenda decisions when the Committee has obtained insufficient evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. We think doing so could risk setting a precedent that the Committee will provide technical analysis on all matters submitted to it, even when the evidence obtained indicates that the matter is not widespread (including when evidence suggests there is little diversity in the accounting treatment entities apply).

23. We are also of the view that explaining the accounting in the tentative agenda decision is unnecessary to prevent new diversity from arising. Entities have been applying IFRS 16 since the Standard became effective for annual reporting periods beginning on or after 1 January 2019 and fact patterns similar to the one described in the submission have existed for many years—we have no evidence that the prevalence of non-refundable VAT on lease payments has increased in the recent past or is expected

[4] The criterion in paragraph 5.16(b) of the *Due Process Handbook* is that 'it is necessary to add or change requirements in IFRS Standards to improve financial reporting—that is, the principles and requirements in the Standards do not provide an adequate basis for an entity to determine the required accounting'.

to in the future. For these reasons, in our view it is unlikely that significant new diversity would arise now after entities have applied the Standard for a number of years.

24. If the Committee decides to finalise the agenda decision with no explanatory material, it would be making no comment on how an entity accounts for non-refundable VAT. The agenda decision would simply state that the Committee decided not to add a standard-setting project to the work plan because there was insufficient evidence that the matter has widespread effect and has, or is expected to have, a material effect on lessees affected. Therefore, finalising the agenda decision without explanatory material would not in our view affect the way lessees currently account for non-refundable VAT.

25. Paragraph 117 of IAS 1 *Presentation of Financial Statements* requires an entity to disclose its significant accounting policies that are relevant to an understanding of the entity's financial statements.[5] Lessees for whom non-refundable VAT is material would therefore consider disclosing their accounting policy applying IAS 1.

26. The Committee could include a reference to the requirements in paragraph 117 of IAS 1 in the agenda decision. However, we have not recommended doing so because, without other explanatory material, including such a reference might imply that lessees have an accounting policy choice to make on whether to include non-refundable VAT as part of lease payments. As discussed in paragraph 24 above, an agenda decision without explanatory material would make no comment on how an entity accounts for non-refundable VAT.

Post-implementation review of IFRS 16

27. Although our view is that the Committee has obtained insufficient evidence to conclude that the criterion in paragraph 5.16(a) of the *Due Process Handbook* is met, we note that stakeholders will have another opportunity to provide input on the matter as part of the Post-implementation Review of IFRS 16. Because it was not a topic

[5] In February 2021, the Board amended paragraph 117 of IAS 1 to require entities to disclose 'material accounting policy information' (instead of the entity's 'significant accounting policies') and added related requirements. The amendments are effective for annual reporting periods beginning on or after 1 January 2023.

stakeholders raised as a significant matter during the development of IFRS 16, the Board did not specifically consider the accounting for non-refundable VAT on lease payments when developing the Standard. We note that other Standards—such as IAS 2 *Inventories*, IAS 16 and IAS 40 *Investment Property*—specifically discuss non-refundable taxes. This is therefore a topic on which the Board may wish to seek further input as part of the Post-implementation Review of IFRS 16.

Other comments

28. The following table summarises respondents' comments on other matters together with our analysis of these comments.

Respondents' comments	**Staff analysis and conclusions**
1. The agenda decision should describe the observed accounting practice EY says the Committee could improve the agenda decision by describing the accounting practice of which it was informed and whether the limited diversity is a result of differences in fact patterns (for example, whether non-refundable VAT is a cost of the lessee or the lessor). Alternatively, EY suggests providing educational material.	*We recommend no change.* In our view, the Committee should not describe the predominant accounting practice of which it was informed in its outreach.[6] As discussed at the Committee's March 2021 meeting, doing so could be perceived as the Committee endorsing such practice, even though the Committee did not discuss or reach conclusions on that accounting. Furthermore, in our view, neither the Committee nor the Board should develop educational material on the matter for the reasons discussed earlier in this paper.
2. Wording suggestion Deloitte says the agenda decision should refer to 'Value added tax and other similar taxes' to clarify that it applies to other tax regimes with similar terms.	*We recommend no change.* We disagree with adding a reference to 'other similar taxes'. The Committee specifically discussed VAT and not other types of taxes that tax authorities might charge on lease payments in other fact patterns. We think adding a general

[6] Almost all outreach respondents said lessees do not—or generally do not—include non-refundable VAT as part of lease payments. See paragraphs 17–19 of Agenda Paper 3 for the Committee's March 2021 meeting.

Respondents' comments	Staff analysis and conclusions
	reference to 'other similar taxes' could capture fact patterns beyond those the Committee considered.

Staff recommendation

29. Based on our analysis, we recommend finalising the agenda decision as published in IFRIC *Update* in March 2021, with the minor changes suggested in Appendix A to this paper. If the Committee agrees with our recommendation, we will ask the Board whether it objects to the agenda decision at the first Board meeting at which it is practicable to present the agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision as explained in paragraph 29 of this paper?

Appendix A—proposed wording of the agenda decision

A1. We propose the following wording for the agenda decision, which is unchanged from the tentative agenda decision except to refer to the comment letters and remove the square brackets in the last paragraph. New text is underlined and deleted text is struck through.

Non-refundable Value Added Tax on Lease Payments (IFRS 16 *Leases*)

The Committee received a request about how a lessee accounts for any non-refundable value added tax (VAT) charged on lease payments. In the fact pattern described in the request:

a. the lessee operates in a jurisdiction in which VAT is charged on goods and services. A seller includes VAT in an invoice for payment issued to a purchaser. In the case of leases, VAT is charged when an invoice for payment is issued by a lessor to a lessee.

b. the applicable legislation:

   i. requires a seller to collect VAT and remit it to the government; and

   ii. generally allows a purchaser to recover from the government VAT charged on payments for goods or services, including leases.

c. because of the nature of its operations, the lessee can recover only a portion of the VAT charged on purchased goods or services. This includes VAT charged on payments it makes for leases. Consequently, a portion of the VAT the lessee pays is non-refundable.

d. lease agreements require the lessee to make payments to the lessor that include amounts related to VAT charged in accordance with the applicable legislation.

The request asked whether, in applying IFRS 16, the lessee includes non-refundable VAT as part of the lease payments for a lease.

Outreach conducted by the Committee and comment letters received provided limited evidence:

a. that non-refundable VAT on lease payments is material to affected lessees; and

b. of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.

The Committee has therefore not ~~[yet]~~ obtained evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. Consequently, the Committee ~~[~~decided~~]~~ not to add a standard-setting project to the work plan.