



A new **lease** on life

A conversation about lease accounting

YOUR KEY TO THE TAX COMMUNITY

Welcome

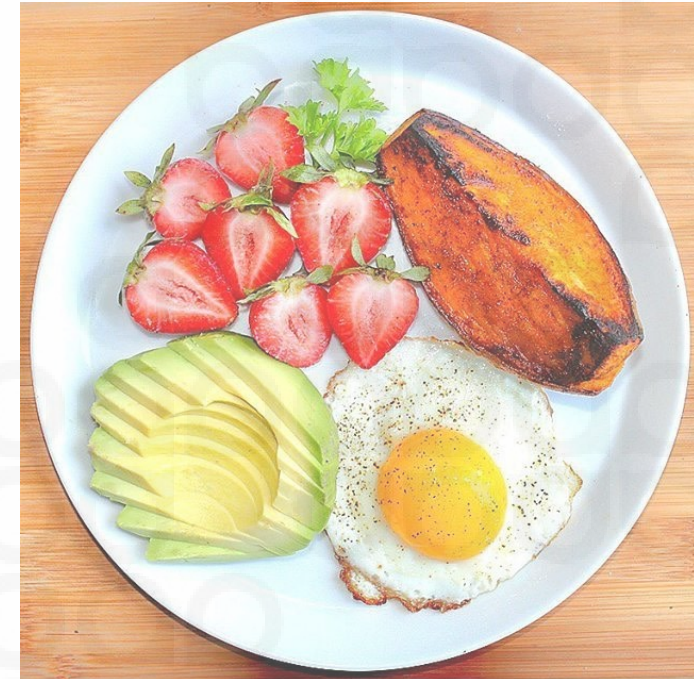
On the lunch plate today

1. **Tax focus points** touching on lease agreements
 1. VAT treatment of lease agreements
 2. Income tax treatment of lease agreements

2. **Accounting focus points** touching on lease agreements
 - a) **Identifying** lease agreements
 - b) **Classifying** lease agreements
 - c) Accounting for lease agreements in the records of the **lessee**
 - d) Accounting for lease agreements in the records of the **lessor**

3. **New developments** in lease accounting
 - a) IFRS 16 *Leases*
 - b) IFRS for SMEs?

4. Conclusionary remarks



Tax focus points touching on lease agreements

VAT treatment of lease agreements (consider whether taxable/exempt)

“instalment credit agreement” means any agreement entered into on or after the commencement date whereby any goods consisting of corporeal movable goods or of any machinery or plant, whether movable or immovable—

<p>(a) are supplied under a sale under which—</p> <ul style="list-style-type: none"> i. the goods are sold by the seller to the purchaser against payment by the purchaser to the seller of a stated or determinable sum of money at a stated or determinable future date or in whole or in part in instalments over a period in the future; and ii. such sum of money includes finance charges stipulated in the agreement of sale; and iii. the aggregate of the amounts payable by the purchaser to the seller under such agreement exceeds the cash value of the supply; and iv. (aa) the purchaser does not become the owner of those goods merely by virtue of the delivery to or the use, possession or enjoyment by him thereof; or (bb) the seller is entitled to the return of those goods if the purchaser fails to comply with any term of that agreement; 	<p>(b) are supplied under a lease under which—</p> <ul style="list-style-type: none"> i. the rent consists of a stated or determinable sum of money payable at a stated or determinable future date or periodically in whole or in part in instalments over a period in the future; and ii. such sum of money includes finance charges, including any amount determined with reference to the time value of money, stipulated in the lease; and iii. the aggregate of the amounts payable under such lease by the lessee to the lessor for the period of such lease (disregarding the right of any party thereto to terminate the lease before the end of such period) and any residual value of the leased goods on termination of the lease, as stipulated in the lease, exceeds the cash value of the supply; and iv. the lessee is entitled to the possession, use or enjoyment of those goods for a period of at least 12 months; and v. (aa) the lessee accepts the full risk of destruction or loss of, or other disadvantage to, those goods and assumes all obligations of whatever nature arising in connection with the insurance, maintenance and repair of those goods while the agreement remains in force; or (bb) (A) the lessor accepts the full risk of destruction or loss of, or other disadvantage to those goods and assumes all obligations of whatever nature arising in connection with the insurance of those goods; and (B) the lessee accepts the full risk of maintenance and repair of those goods and reimburses the lessor for the insurance of those goods, while the agreement remains in force;
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Tax focus points touching on lease agreements

Income tax treatment of lease agreements

- “A lease is a lease”
- Does it matter whether it is an Operating lease or a Finance lease?

Lessor	Lessee
Legal owner, claim capital allowance (if available)	No capital allowance claimable on the asset
Recognise gross income	Claim tax deduction <ul style="list-style-type: none"> • Removing VAT could be a complication if the lease is an instalment credit agreement (apportionment necessary)

Acc focus points touching on lease agreements

Identifying lease agreements – S20 IFRS for SMEs

- ✓ All arrangements should be considered for the possibility of being/containing a lease agreement
- ✓ A contract is, or contains, a **lease** if the contract:
 - conveys the **right to control the use** (i.e., right of/to use)
 - of an **identified asset**
 - for a **period** of time
 - in exchange for **consideration**
- ✓ **Control** is conveyed where the customer has both:
 - the right to **direct** the identified asset's use and
 - to **obtain** substantially all the economic benefits from that use
- ✓ Where a supplier has **substantive substitution rights** throughout the period of use
 - No identified asset for the customer, hence no lease
- ✓ When are the supplier's substitution rights **substantive**?
 - Supplier has practical ability to substitute alternative assets throughout the period of use and
 - Supplier would economically benefit from substitution (*i.e., commercial motivation*)

Acc focus points touching on lease agreements

Classifying lease agreements

- ✓ **Two types** of lease agreements in accounting
 - **Operating leases** (line up nicely with income tax treatment)
 - **Finance leases** (problematic for tax purposes)
- ✓ So how to **decide (classify)** between the types of lease agreements?
 - Always based on *economic substance*, and not merely legal form!
 - Not always a clear-cut decision!
 - Same considerations applicable to lessor and lessee
 - *Indicators* that risks and rewards associated with ownership have transferred to the lessee i.t.o. the lease agreement
 - ❖ Strong indicators: likely to be **finance** lease
 - ❖ Weak indicators: likely to be **operating** lease
 - Primary indicators to consider
 - ❖ Legal title transfers?
 - ❖ Bargain purchase option?
 - ❖ Lease term equals majority of economic life of leased asset?
 - ❖ PV of lease payments = at least substantially all of the FV of the leased asset?
 - ❖ Highly specialised leased asset?
 - Lessor and lessee could have different classifications of the same lease

Acc focus points touching on lease agreements

Accounting for lease agreements by the **lessee**

- ✓ Distinguish between full IFRS (IFRS 16) and IFRS for SMEs (Section 20)

- ✓ **Operating leases**
 - Substance: lease of an asset (right to use) by the lessee without transfer of R&R's
 - Recognition principle (expense)
 - Straight-lining of uneven lease instalments (why?)
 - Deferred tax implications?

- ✓ **Finance leases**
 - Substance: 'financed acquisition' by the lessee (R&R's transfer to lessee)
 - Recognition principle (leased asset and corresponding lease liability) (*effect on NAV = 0*)
 - Initial measurement (@cost, use rate implicit in the lease)
 - Subsequent measurement (@amortised cost (similar to amort schedule with split between interest expense and capital of instalment), depreciation of leased asset)
 - Deferred tax implications?

Acc focus points touching on lease agreements

Accounting for lease agreements by the **lessor**

- ✓ Accounted for the same way in full IFRS (IFRS 16) as IFRS for SMEs (Section 20)

- ✓ **Operating leases**
 - Substance: leasing out an asset by the lessor without transfer of R&R's
 - Recognition principle (income received/revenue)
 - Straight-lining of uneven lease instalments (why?)
 - Depreciation and impairment testing of asset subject to lease
 - Deferred tax implications?

- ✓ **Finance leases**
 - Substance: 'financed disposal' by the lessor (R&R's transfer to lessee)
 - Recognition principle (replace asset by gross receivable, with corresponding credits)
 - Initial measurement (G.I.L. less U.F.I. = N.I.L.)
 - Subsequent measurement (@amortised cost (similar to amort schedule with split between interest income and capital of instalment), realisation of U.F.I. to P&L)
 - Deferred tax implications?

New developments in lease accounting

IFRS 16 *Leases*

- ✓ Why even look at full IFRS?
- ✓ Updates to conceptual framework for financial reporting (2018)
 - Definition of asset: A present economic resource controlled by the entity arising from past events
 - ❖ Present economic resource = **a right** that has the **potential** to produce economic benefits
- ✓ How is IFRS 16 different to Section 20 of the IFRS for SMEs?
 - Only lessees affected, lessors accounted for the same way
 - **Lessee**
 - ❖ All lease agreements capitalised, hence lease classification not an issue anymore
 - ❖ Purpose: to address risk of off-balance sheet financing, impact on ratio analysis etc.
 - ❖ Recognition of R-O-U (right of use) asset, not actual asset being leased e.g. PP&E
 - ❖ Capitalisation of provisions for dismantling/environmental rehab still possible
 - ❖ Recognition of corresponding lease liability
 - ❖ Subsequent measurement similar to finance lease, R-O-U asset depreciated to P&L over lease term
 - ❖ R-O-U asset can be disclosed in notes to AFS on its own, or as part of actual asset category (e.g. land, equipment etc.)
 - ❖ Exceptions to the above treatment
 - Short-term leases (12 months or less)
 - Leases of low value assets (US\$5k or less)
 - ❖ Deferred tax implications?

New developments in lease accounting

IFRS for SMEs?

- ✓ IASB is undertaking research i.r.o. the need for a **comprehensive revision** of the IFRS for SMEs
- ✓ When will the outcome be known?
- ✓ Possible impact on **IFRS for SMEs**?
 - Capitalisation of all lease agreements by the lessee

Conclusionary remarks

Transaction	VAT	Inc tax	Acc	Risk
Lessee: O/Lease	ICA/Rental agreement	Lease	Expense instalments in P/L	Straight-line?
Lessee: F/Lease	ICA/Rental agreement	Lease	SOF: Financed acquisition of A	Complex tax adjustments
Lessor: O/Lease	ICA/Rental agreement	Lease	Recognise instalments in P/L	Straight-line?
Lessor: F/Lease	ICA/Rental agreement	Lease	SOF: Financed sale of A	Complex tax adjustments
Instalment sales agreement (ISA)	Most often ICA	Acquisition/ Sale	Acquisition/ Sale	Relatively straight-forward



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