

# IFRS AT A GLANCE

*SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease*





# SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*

Effective Date  
Periods beginning on or after 31 December 2001

BACKGROUND	ISSUE
<p>SIC-27 applies to situations where an entity A leases or sales an asset to an investor B and leases the same asset back. The lease may cover the whole economic life or the entity may have the right to buy the asset back at the end of the lease period.</p> <p>The purpose of the arrangement is often to achieve a tax advantage.</p>	<p>When an arrangement with an investor involves the legal form of a lease, the issues are:</p> <ul style="list-style-type: none"> <li>• How to determine whether a series of transactions is linked and should be accounted for as one transaction?</li> <li>• Whether the arrangement meets the definition of a lease under IAS 17 <i>Leases</i>; and, if not:               <ul style="list-style-type: none"> <li>– Whether a separate investment account and lease payment obligations that might exist represent assets and liabilities of the entity?</li> <li>– How the entity should account for other obligations resulting from the arrangement?</li> <li>– How the entity should account for a fee it might receive from an investor?</li> </ul> </li> </ul>

CONSENSUS
<ul style="list-style-type: none"> <li>• A series of transactions that involve the legal form of a lease are linked and are accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole</li> <li>• IAS 17 applies when the substance of an arrangement includes the conveyance of the right to use an asset for an agreed period of time. Indicators that individually demonstrate that an arrangement may not, in substance, involve a lease under IAS 17 include:           <ul style="list-style-type: none"> <li>– An entity retains all the risks and rewards incident to ownership of an underlying asset and enjoys substantially the same rights to its use as before the arrangement</li> <li>– The primary reason for the arrangement is to achieve a particular tax result, and not to convey the right to use an asset</li> <li>– An option is included on terms that make its exercise almost certain (e.g., a put option that is exercisable at a price sufficiently higher than the expected fair value when it becomes exercisable).</li> </ul> </li> <li>• The definitions and guidance in the Framework should be applied in determining whether, in substance, a separate investment account and lease payment obligations represent assets and liabilities of the entity. Indicators that collectively demonstrate that, in substance, a separate investment account and lease payment obligations do not meet the definitions of an asset and a liability and should not be recognised by the entity include:           <ul style="list-style-type: none"> <li>– The entity is not able to control the investment account in pursuit of its own objectives and is not obligated to pay the lease payments:</li> <li>– The entity has only a remote risk of reimbursing the entire amount of any fee received from an investor and possibly paying some additional amount, or, when a fee has not been received, only a remote risk of paying an amount under other obligations</li> <li>– Other than the initial cash flows at inception of the arrangement, the only cash flows expected under the arrangement are the lease payments that are satisfied solely from funds withdrawn from the separate investment account established with the initial cash flows.</li> </ul> </li> <li>• Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, should be accounted for under IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>, IAS 39 <i>Financial Instruments: Recognition &amp; Measurement</i> or IFRS 4 <i>Insurance Contracts</i>, depending on the terms</li> <li>• The criteria in IAS 18 <i>Revenue</i> are applied to the facts and circumstances of each arrangement to determine when to recognise a fee as income that the entity might receive</li> <li>• The fee should be presented in the statement of comprehensive income based on its economic substance and nature.</li> </ul>

DISCLOSURE
<p>An entity discloses the following in each period that an arrangement exists:</p> <ul style="list-style-type: none"> <li>• A description of the arrangement including:           <ul style="list-style-type: none"> <li>– The underlying asset and any restrictions on its use</li> <li>– The life and other significant terms of the arrangement</li> <li>– The transactions that are linked together, including any options</li> <li>– The accounting treatment applied to any fee received, the amount recognised as income in the period, and the line item of the statement of comprehensive income in which it is included.</li> </ul> </li> <li>• Disclosure is required to be provided individually for each arrangement or in aggregate for each class of arrangement.</li> </ul>

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